ALTERNATIVE PLANS FOR TAX RELIEF FOR INDIVIDUALS

PREPARED BY THE

STAFF OF THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

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LETTER OF SUBMITTAL

Congress of the United States,
Joint Committee on Internal Revenue Taxation,
Washington, February 25, 1958.

Hon. Harry F. Byrd,
Chairman, Joint Committee on Internal Revenue Taxation.

Dear Senator Byrd: Numerous requests have been received by the staff as to the revenue effects of various plans for reducing taxes on individuals. This pamphlet is a compilation of such plans. It is published for the information of the Congress and has not been considered or approved by the Joint Committee on Internal Revenue Taxation or any member thereof. If any one of the plans is seriously considered by the Congress, it will, of course, be necessary to complete the technical details which would be involved in the drafting of a bill carrying out the plan.

The arrangement of the plans in the pamphlet is for convenience only and is not intended to indicate any preference of one plan over another.

Respectfully yours,

Colin F. Stam, *Chief of Staff.*

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ALTERNATIVE PLANS FOR TAX RELIEF FOR INDIVIDUALS

PART I—GENERAL

A. Estimated Distribution of the Individual Income-Tax Returns, Adjusted Gross Income and Tax Liability Under Existing Tax Rates

[Money amounts in millions]

Adjusted gross income (thousands)	Number of taxable returns (thousands)	Adjusted gross income	Tax
Under $1	1, 306. 1	$1, 098	$39
$1 to $2	4, 609. 4	6, 933	532
$2 to $3	5, 883. 2	14, 849	1, 311
$3 to $4	6, 905. 6	24, 188	2, 173
$4 to $5	8, 035. 5	36, 132	3, 324
Total under $5	26, 739. 7	83, 200	7, 379
$5 to $7	11, 658. 4	68, 587	7, 159
$7 to $10	6, 639. 7	54, 328	6, 904
$10 to $25	2, 974. 6	41, 181	6, 784
$25 to $50	397. 9	13, 324	3, 520
$50 to $100	97. 6	6, 459	2, 409
$100 to $200	21. 8	2, 852	1, 235
$200 to $500	5. 4	1, 511	799
$500 to $1,000	. 8	551	327
$1,000 and over	. 3	624	369
Total over $5	21, 796. 5	189, 417	29, 506
Total	48, 536. 2	272, 617	36, 885
PERCENTAGE DISTRIBUTIONS			
Under $1	2. 69	0. 40	0. 11
$1 to $2	9. 50	2. 54	1. 44
$2 to $3	12. 12	5. 45	3. 55
$3 to $4	14. 23	8. 87	5. 89
$4 to $5	16. 56	13. 25	9. 01
Total under $5	55. 09	30. 52	20. 01
$5 to $7	24. 02	25. 16	19. 41
$7 to $10	13. 68	19. 93	18. 72
$10 to $25	6. 13	15. 11	18. 39
$25 to $50	. 82	4. 89	9. 54
$50 to $100	. 20	2. 37	6. 53
$100 to $200	. 04	1. 05	3. 35
$200 to $500	. 01	. 55	2. 17
$500 to $1,000	(1)	. 20	. 89
$1,000 and over	(1)	. 23	1. 00
Total over $5	44. 91	69. 48	79. 99
Total	100. 00	100. 00	100. 00

[1] Less than 0.005 percent.

Note.—Detail may not add to totals due to rounding.

B. Comparison of the Progression in Tax Rates in the United States With That in Canada at Various Taxable Income Levels

The basic or starting rate in the United States is 20 percent and in Canada 13 percent.

Taxable income	Percentage point progressive or marginal rate on top dollar of income		
	United States		Canada
	Married couple	Single person	
$1,000			
$2,000			2
$3,000		2	4
$5,000	2	6	7
$7,000	2	10	11
$10,000	6	14	15
$15,000	10	27	25
$25,000	23	39	35
$50,000	39	52	40
$100,000	52	67	50
$150,000	61	69	55
$200,000	67	70	55
$300,000	69	71	60
$500,000	71	71	65

PART II—"QUICKIE" TAX RELIEF

(1) This suggestion would reduce the withholding rate from 18 percent to 9 percent for a 6-month period beginning July 1, 1958. It also provides for an accompanying adjustment in the final liability. Such a plan would increase the purchasing power of the wage earner by about $1.2 billion a month. In the case of taxpayers not subject to withholding, adjustments could be made in their declarations.

This plan could be extended for a longer period if economic conditions warranted. The following table indicates the reduction of withheld taxes under various salary levels and exemption classes.

Weekly earnings	Earnings in 6-month period	6 months reduction in withheld tax under plan		
		1 exemption	2 exemptions	4 exemptions
$50	$1, 300	$87	$56	(1)
$75	1, 950	145	115	$54
$100	2, 600	204	173	112
$125	3, 250	262	232	171
$150	3, 900	321	290	229
$175	4, 550	379	349	288
$200	5, 200	438	407	346

[1] No withholding under present law.

(2) This plan would double the $13 value of the present per capita weekly withholding exemption with proper adjustments in other pay period exemptions. This would increase to $26 each per capita exemption claimed by the wage earner. The plan could be adopted on July 1, 1958, for a 6-month period, or extended longer if desired.

For a worker with a family of 4, this plan would increase his weekly take home pay by $9.36, and for a 6-month period by $243.36.

Adoption of such a plan would put into consumer spendable income approximately $1 billion a month.

PART III—OTHER

A. Change in Exemptions

PLAN 1

Plan 1 would increase the present $600 per capita exemptions to $700. This would relieve 4,200,000 taxpayers from all income-tax liability.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	$1, 092	39. 5
$5,000 to $10,000	1, 306	47. 3
Over $10,000	366	13. 2
Total	2, 764	100. 0

Burden table for plan 1

Income before deduction for personal exemptions	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$60	$20	25.0
$2,000	280	260	20	7.1
$3,000	488	466	22	4.5
$4,000	708	686	22	3.1
$5,000	944	918	26	2.8
$8,000	1,780	1,750	30	1.7
$10,000	2,436	2,402	34	1.4
$15,000	4,448	4,401	47	1.1
$25,000	9,796	9,737	59	.6
$50,000	26,388	26,316	72	.3
$100,000	66,798	66,711	87	.1
$500,000	429,274	429,183	91	(2)
$1,000,000	[1] 869,478	[1] 869,478	----------	--------
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$120	$40	25.0
$3,000	360	320	40	11.1
$4,000	560	520	40	7.1
$5,000	760	720	40	5.3
$8,000	1,416	1,372	44	3.1
$10,000	1,888	1,836	52	2.8
$15,000	3,260	3,200	60	1.8
$25,000	6,724	6,648	76	1.1
$50,000	19,592	19,474	118	.6
$100,000	52,776	52,632	144	.3
$500,000	403,548	403,366	182	(2)
$1,000,000	858,548	858,366	182	(2)
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$40	$80	66.7
$4,000	320	240	80	25.0
$5,000	520	440	80	15.4
$8,000	1,152	1,064	88	7.6
$10,000	1,592	1,504	88	5.5
$15,000	2,900	2,780	120	4.1
$25,000	6,268	6,116	152	2.4
$50,000	18,884	18,648	236	1.2
$100,000	51,912	51,624	288	.6
$500,000	402,456	402,092	364	.1
$1,000,000	857,456	857,092	364	(2)

[1] Maximum effective rate limitation 87 percent of taxable income.
[2] Less than 0.05 percent.

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PLAN 2

Plan 2 would increase the present $600 per capita exemptions to $650 and in addition provide for a 5-percent reduction in tax. This would relieve 2,100,000 taxpayers from all tax liability.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	901	28. 7
$5,000 to $10,000	1, 311	41. 8
Over $10,000	928	29. 5
Total	3, 140	100. 0

Burden table for plan 2

Income before deduction for personal exemptions	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$67	$14	16. 9
$2,000	280	257	24	8. 6
$3,000	488	453	35	7. 2
$4,000	708	662	46	6. 5
$5,000	944	884	60	6. 4
$8,000	1, 780	1, 677	103	5. 8
$10,000	2, 436	2, 298	138	5. 7
$15,000	4, 448	4, 203	245	5. 5
$25,000	9, 796	9, 278	518	5. 3
$50,000	26, 388	25, 034	1, 354	5. 1
$100,000	66, 798	63, 417	3, 381	5. 1
$500,000	429, 274	407, 767	21, 507	5. 0
$1,000,000	[1] 869, 478	840, 017	29, 461	3. 4
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$133	$27	16. 9
$3,000	360	323	37	10. 3
$4,000	560	513	47	8. 4
$5,000	760	703	57	7. 5
$8,000	1, 416	1, 324	92	6. 5
$10,000	1, 888	1, 769	119	6. 3
$15,000	3, 260	3, 069	191	5. 9
$25,000	6, 724	6, 352	372	5. 5
$50,000	19, 592	18, 556	1, 036	5. 3
$100,000	52, 776	50, 069	2, 707	5. 1
$500,000	403, 548	383, 284	20, 264	5. 0
$1,000,000	858, 548	815, 534	43, 014	5. 0
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$76	$44	36. 7
$4,000	320	266	54	16. 9
$5,000	520	456	64	12. 3
$8,000	1, 152	1, 053	99	8. 6
$10,000	1, 592	1, 471	121	7. 6
$15,000	2, 900	2, 698	202	7. 0
$25,000	6, 268	5, 882	386	6. 2
$50,000	18, 884	17, 828	1, 056	5. 6
$100,000	51, 912	49, 180	2, 732	5. 3
$500,000	402, 456	382, 160	20, 296	5. 0
$1,000,000	857, 456	814, 410	43, 046	5. 0

[1] Maximum effective rate limitation 87 percent of taxable income.

B. Tax Credits

PLAN 3

This plan would provide a $20 tax credit for each personal and dependency exemption claimed by the taxpayer. An estimated 4,200,000 taxpayers would be relieved of all tax liability.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	1, 083	42. 6
$5,000 to $10,000	1, 220	48. 0
Over $10,000	240	9. 4
Total	2, 543	100. 0

Burden table for plan 3

Income before deduction for personal exemptions	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$60	$20	25.0
$2,000	280	260	20	7.1
$3,000	488	468	20	4.1
$4,000	708	688	20	2.8
$5,000	944	924	20	2.1
$8,000	1,780	1,760	20	1.1
$10,000	2,436	2,416	20	.8
$15,000	4,448	4,428	20	.4
$25,000	9,796	9,776	20	.2
$50,000	26,388	26,368	20	.1
$100,000	66,798	66,778	20	(2)
$500,000	429,274	429,254	20	(2)
$1,000,000	(1) 869,478	(1) 869,458	20	(2)
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$120	$40	25.0
$3,000	360	320	40	11.1
$4,000	560	520	40	17.1
$5,000	760	720	40	5.3
$8,000	1,416	1,376	40	2.8
$10,000	1,888	1,848	40	2.1
$15,000	3,260	3,220	40	1.2
$25,000	6,724	6,684	40	.6
$50,000	19,592	19,552	40	.2
$100,000	52,776	52,736	40	.1
$500,000	403,548	403,508	40	(2)
$1,000,000	858,548	858,508	40	(2)
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$40	$80	66.7
$4,000	320	240	80	25.0
$5,000	520	440	80	15.4
$8,000	1,152	1,072	80	6.9
$10,000	1,592	1,512	80	5.0
$15,000	2,900	2,820	80	2.8
$25,000	6,268	6,188	80	1.3
$50,000	18,884	18,804	80	.4
$100,000	51,912	51,832	80	.2
$500,000	402,456	402,376	80	(2)
$1,000,000	857,456	857,376	80	(2)

[1] Maximum effective rate limitation 87 percent of taxable income.
[2] Less than 0.05 percent.

PLAN 4

Plan 4 would provide a tax credit of $140 for each exemption claimed by the taxpayer in lieu of the present deduction of $600 for each exemption. For taxpayers in the first income-tax bracket under present law and under the plan the $140 tax credit would result in a tax saving of $20 more per exemption claimed than they receive from the present $600 exemption. In addition there would be a reduction of 1 percentage point in the tax rate on the first $2,000 of taxable income and 3 percentage points in all other rates. This 3-percentage-point reduction above the first income-tax bracket is suggested to compensate for and give relief to those taxpayers whose benefit by way of the conversion of the exemption into a tax credit has been taken away. In addition the percentage point reduction will have the effect of increasing the first surtax bracket of $2,000 to $4,000. The effect of this, so far as administrative simplicity is concerned will be to eliminate additional assessments on the low-income taxpayers because withholding will more closely approximate the actual liability. For example, a single person with a $4,000 salary is under present law underwithheld on by $20. Broadening the bracket to $4,000 will eliminate this underwithholding.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	$1, 764	35. 0
$5,000 to $10,000	2, 419	48. 0
Over $10,000	856	17. 0
Total	5, 039	100. 0

Burden table for plan 4

Income before deduction for personal exemptions	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$50	$30	38
$2,000	280	240	40	14
$3,000	488	430	58	12
$4,000	708	620	88	12
$5,000	944	850	94	10
$8,000	1, 780	1, 620	160	9
$10,000	2, 436	2, 240	196	8
$15,000	4, 448	4, 180	268	6
$25,000	9, 796	9, 300	496	5
$50,000	26, 388	25, 220	1, 168	4
$100,000	66, 798	64, 220	2, 578	4
$500,000	429, 274	414, 720	14, 554	3
$1,000,000	[1] 869, 478	854, 720	14, 758	2
MARRIED COUPLE—NO DEPENDENTS				
$1,500	$60	$5	$55	92
$2,000	160	100	60	38
$3,000	360	290	70	19
$4,000	560	480	80	14
$5,000	760	670	90	12
$8,000	1, 416	1, 240	176	12
$10,000	1, 888	1, 700	188	10
$15,000	3, 260	2, 970	290	9
$25,000	6, 724	6, 280	444	7
$50,000	19, 592	18, 600	992	5
$100,000	52, 776	50, 160	2, 616	5
$300,000	222, 572	214, 440	8, 132	4
$500,000	403, 548	389, 440	14, 108	3
$1,000,000	858, 548	829, 440	29, 108	3
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$10	$110	92
$4,000	320	200	120	38
$5,000	520	390	130	25
$8,000	1, 152	960	192	17
$10,000	1, 592	1, 420	172	11
$15,000	2, 900	2, 690	210	7
$25,000	6, 268	6, 000	268	4
$50,000	18, 884	18, 320	564	3
$100,000	51, 912	50, 160	1, 752	3
$300,000	221, 504	214, 160	7, 344	3
$500,000	402, 456	389, 160	13, 296	3
$1,000,000	857, 456	829, 160	28, 296	3

[1] Maximum effective rate limitation 87 percent of taxable income.

C. Rate Changes

PLAN 5

This plan would reduce the present law rates in all brackets by 2 percentage points.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	738	23. 6
$5,000 to $10,000	1, 386	44. 4
Over $10,000	999	32. 0
Total	3, 123	100. 0

Burden table for plan 5

Income before deduction for personal exemptions	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$72	$8	10.0
$2,000	280	252	28	10.0
$3,000	488	440	48	9.8
$4,000	708	640	68	9.6
$5,000	944	856	88	9.3
$8,000	1,780	1,632	148	8.3
$10,000	2,436	2,248	188	7.7
$15,000	4,448	4,160	288	6.5
$25,000	9,796	9,308	488	5.0
$50,000	26,388	25,400	988	3.7
$100,000	66,798	64,810	1,988	3.0
$500,000	429,274	419,286	9,988	2.3
$1,000,000	[1] 869,478	864,286	5,192	.6
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$144	$16	10.0
$3,000	360	324	36	10.0
$4,000	560	504	56	10.0
$5,000	760	684	76	10.0
$8,000	1,416	1,280	136	9.6
$10,000	1,888	1,712	176	9.3
$15,000	3,260	2,984	276	8.5
$25,000	6,724	6,248	476	7.1
$50,000	19,592	18,616	976	5.0
$100,000	52,776	50,800	1,976	3.7
$500,000	403,548	393,572	9,976	2.5
$1,000,000	858,548	838,572	19,976	2.3
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$108	$12	10.0
$4,000	320	288	32	10.0
$5,000	520	468	52	10.0
$8,000	1,152	1,040	112	9.7
$10,000	1,592	1,440	152	9.5
$15,000	2,900	2,648	252	8.7
$25,000	6,268	5,816	452	7.2
$50,000	18,884	17,932	952	5.0
$100,000	51,912	49,960	1,952	3.8
$500,000	402,456	392,504	9,952	2.5
$1,000,000	857,456	837,504	19,952	2.3

[1] Maximum effective rate limitation 87 percent of taxable income.

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PLAN 6

Plan 6 adopts the rates that were in effect prior to the Korean war. These rates were in effect in 1948–49 and range from 16.6 percent on the first $2,000 of taxable income to 82.1 percent on income over $200,000. The rate reduction under this plan would occur in two steps. The first year the rates in effect in 1950 would apply and the second year the pre-Korean rates would be in effect.

Estimated distribution of the tax reduction under this plan (full year effect under pre-Korean rates)

	Millions of dollars	Percentage distribution of decrease
Under $5,000	1, 237	22. 5
$5,000 to $10,000	2, 283	41. 5
Over $10,000	1, 977	36. 0
Total	5, 497	100. 0

Burden table for plan 6

Income before deduction for personal exemptions	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$66	$14	17. 0
$2,000	280	232	48	17. 0
$3,000	488	409	79	16. 2
$4,000	708	603	105	14. 8
$5,000	944	811	133	14. 1
$8,000	1, 780	1, 546	234	13. 1
$10,000	2, 436	2, 124	312	12. 8
$15,000	4, 448	3, 894	554	12. 5
$25,000	9, 796	8, 600	1, 196	12. 2
$50,000	26, 388	23, 201	3, 187	12. 1
$100,000	66, 798	58, 762	8, 036	12. 0
$500,000	429, 274	[1] 384, 538	44, 736	10. 4
$1,000,000	[2] 869, 478	[1] 769, 538	99, 940	11. 5
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$133	$27	17. 0
$3,000	360	299	61	17. 0
$4,000	560	465	95	17. 0
$5,000	760	631	129	17. 0
$8,000	1, 416	1, 206	210	14. 8
$10,000	1, 888	1, 621	267	14. 1
$15,000	3, 260	2, 829	431	13. 2
$25,000	6, 724	5, 877	847	12. 6
$50,000	19, 592	17, 201	2, 391	12. 2
$100,000	52, 776	46, 403	6, 373	12. 1
$500,000	403, 548	359, 662	43, 886	10. 9
$1,000,000	858, 548	[1] 769, 076	89, 472	10. 4
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$100	$20	17. 0
$4,000	320	266	54	17. 0
$5,000	520	432	88	17. 0
$8,000	1, 152	974	178	15. 5
$10,000	1, 592	1, 361	231	14. 5
$15,000	2, 900	2, 512	388	13. 4
$25,000	6, 268	5, 476	792	12. 6
$50,000	18, 884	16, 578	2, 306	12. 2
$100,000	51, 912	45, 643	6, 269	12. 1
$500,000	402, 456	358, 677	43, 779	10. 9
$1,000,000	857, 456	[1] 768, 152	89, 304	10. 4

[1] Maximum effective rate limitation, 77 percent of taxable income.
[2] Maximum effective rate limitation, 87 percent of taxable income.

PLAN 7

Plan 7 applies the Canadian income-tax rates to the Federal tax system in this country. The present Federal provisions, including split income, exemptions and deductions provided under our laws are maintained under the plan. The Canadian rates range from 13 percent on the first $1,000 of taxable income to 78 percent on the income in excess of $400,000. The additional Canadian 4-percent tax on investment income has not been incorporated under this plan.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	2, 405	18. 6
$5,000 to $10,000	4, 175	32. 2
Over $10,000	6, 365	49. 2
Total	12, 945	100. 0

Burden table for plan 7

Income before deduction for personal exemptions	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$52	$28	35. 0
$2,000	280	190	90	32. 1
$3,000	488	348	140	28. 7
$4,000	708	518	190	26. 8
$5,000	944	700	244	25. 8
$8,000	1, 780	1, 356	424	23. 8
$10,000	2, 436	1, 892	544	22. 3
$15,000	4, 448	3, 632	816	18. 3
$25,000	9, 796	7, 902	1, 894	19. 3
$50,000	26, 388	20, 342	6, 046	22. 9
$100,000	66, 798	49, 282	17, 516	26. 2
$500,000	429, 274	338, 692	90, 582	21. 1
$1,000,000	[1] 896, 478	728, 692	140, 786	16. 2
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$104	$56	35. 0
$3,000	360	234	126	35. 0
$4,000	560	380	180	32. 1
$5,000	760	530	230	30. 3
$8,000	1, 416	1, 036	380	26. 8
$10,000	1, 888	1, 400	488	25. 8
$15,000	3, 260	2, 472	788	24. 2
$25,000	6, 724	5, 374	1, 350	20. 1
$50,000	19, 592	15, 804	3, 788	19. 3
$100,000	52, 776	40, 684	12, 092	22. 9
$500,000	403, 548	302, 444	101, 104	25. 1
$1,000,000	858, 548	677, 384	181, 164	21. 1
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$78	$42	35. 0
$4,000	320	208	112	35. 0
$5,000	520	350	170	32. 7
$8,000	1, 152	832	320	27. 8
$10,000	1, 592	1, 172	420	26. 4
$15,000	2, 900	2, 184	716	24. 7
$25,000	6, 268	4, 978	1, 290	20. 6
$50,000	18, 884	15, 288	3, 596	19. 0
$100,000	51, 912	40, 048	11, 864	22. 9
$500,000	402, 456	301, 568	100, 888	25. 1
$1,000,000	857, 456	676, 448	181, 008	21. 1

[1] Maximum effective rate limitation 87 percent of taxable income.

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PLAN 8

Plan 8 would split the first $2,000 taxable income class into 2 classes of $1,000 each and provide a rate of 10 percent on the first $1,000 and leave the present 20-percent rate on the next $1,000. Except for married couples filing joint returns, the tax for those with taxable incomes over $1,000 would be reduced by $100. In the case of married couples filing joint returns the reduction because of split income would amount to $200 where their taxable income exceeds $2,000. For married couples with taxable incomes between $1,000 and $2,000, the reduction would graduate from 50 percent of the tax to $200. The plan would have the effect of reducing all taxpayers' tax by 50 percent if their taxable income is $1,000 or less.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	2, 802	40. 3
$5,000 to $10,000	3, 481	50. 1
Over $10,000	670	9. 6
Total	6, 953	100. 0

PLAN 9

Plan 9 would split the first $2,000 tax bracket with a tax rate of 18 percent on the first $1,000 of taxable income and in addition provide a 5 percent reduction in all other tax rates.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	651	25. 8
$5,000 to $10,000	1, 055	41. 8
Over $10,000	819	32. 4
Total	2, 525	100. 0

Burden table for plan 9

Income before deduction for personal exemptions	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$72	$8	10.0
$2,000	280	256	24	8.6
$3,000	488	454	34	7.0
$4,000	708	663	45	6.4
$5,000	944	887	57	6.0
$8,000	1,780	1,681	99	5.6
$10,000	2,436	2,304	132	5.4
$15,000	4,448	4,216	232	5.2
$25,000	9,796	9,296	500	5.1
$50,000	26,388	25,059	1,329	5.0
$100,000	66,798	63,448	3,350	5.0
$500,000	429,274	407,800	21,474	5.0
$1,000,000	[1] 869,478	[2] 826,004	43,474	5.0
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$144	$16	10.0
$3,000	360	324	36	10.0
$4,000	560	512	48	8.6
$5,000	760	702	58	7.6
$8,000	1,416	1,325	91	6.4
$10,000	1,888	1,774	114	6.0
$15,000	3,260	3,077	183	5.6
$25,000	6,724	6,368	356	5.3
$50,000	19,592	18,592	1,000	5.1
$100,000	52,776	50,117	2,659	5.0
$500,000	403,548	383,351	20,197	5.0
$1,000,000	858,548	815,601	42,947	5.0
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$108	$12	10.0
$4,000	320	288	32	10.0
$5,000	520	474	46	8.8
$8,000	1,152	1,074	78	6.8
$10,000	1,592	1,492	100	6.3
$15,000	2,900	2,735	165	5.7
$25,000	6,268	5,935	333	5.3
$50,000	18,884	17,920	964	5.1
$100,000	51,912	49,296	2,616	5.0
$500,000	402,456	382,313	20,143	5.0
$1,000,000	857,456	814,563	42,893	5.0

[1] Maximum effective rate limitation 87 percent of taxable income.
[2] Maximum effective rate limitation 82.65 percent of taxable income.

PLAN 10

Plan 10 would provide a 10 percent reduction in tax. This could be incorporated into the tax table so as not to make necessary a separate computation by the taxpayer.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	742	20. 3
$5,000 to $10,000	1, 413	38. 6
Over $10,000	1, 504	41. 1
Total	3, 659	100. 0

Burden table for plan 10

Income before deduction for personal exemptions	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$72	$8	10.0
$2,000	280	252	28	10.0
$3,000	488	439	49	10.0
$4,000	708	637	71	10.0
$5,000	944	850	94	10.0
$8,000	1,780	1,602	178	10.0
$10,000	2,436	2,192	244	10.0
$15,000	4,448	4,003	445	10.0
$25,000	9,796	8,816	980	10.0
$50,000	26,388	23,749	2,639	10.0
$100,000	66,798	60,118	6,680	10.0
$500,000	429,274	386,347	42,927	10.0
$1,000,000	[1] 869,478	[2] 782,530	86,948	10.0
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$144	$16	10.0
$3,000	360	324	36	10.0
$4,000	560	504	56	10.0
$5,000	760	684	76	10.0
$8,000	1,416	1,274	142	10.0
$10,000	1,888	1,699	189	10.0
$15,000	3,260	2,934	326	10.0
$25,000	6,724	6,052	672	10.0
$50,000	19,592	17,633	1,959	10.0
$100,000	52,776	47,498	5,278	10.0
$500,000	403,548	363,193	40,355	10.0
$1,000,000	858,548	772,693	85,855	10.0
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$108	$12	10.0
$4,000	320	288	32	10.0
$5,000	520	468	52	10.0
$8,000	1,152	1,037	115	10.0
$10,000	1,592	1,433	159	10.0
$15,000	2,900	2,610	290	10.0
$25,000	6,268	5,641	627	10.0
$50,000	18,884	16,996	1,888	10.0
$100,000	51,912	46,721	5,191	10.0
$500,000	402,456	362,210	40,246	10.0
$1,000,000	857,456	771,710	85,746	10.0

[1] Maximum effective rate limitation 87 percent of taxable income.
[2] Maximum effective rate limitation 78.3 percent of taxable income.

PLAN 11

Plan 11 provides a 10-percent reduction in tax on the first $2,000 of taxable income and 5 percent reduction in the tax on taxable income over $2,000. These percentages could be worked into the rate schedule to eliminate the necessity of the taxpayer making extra computations.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	715	25. 3
$5,000 to $10,000	1, 278	45. 3
Over $10,000	831	29. 4
Total	2, 824	100. 0

Burden table for plan 11

Income before deduction for personal exemptions	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$72	$8	10. 0
$2,000	280	252	28	10. 0
$3,000	488	444	44	9. 1
$4,000	708	653	55	7. 8
$5,000	944	877	67	7. 1
$8,000	1, 780	1, 671	109	6. 1
$10,000	2, 436	2, 294	142	5. 8
$15,000	4, 448	4, 206	242	5. 4
$25,000	9, 796	9, 286	510	5. 2
$50,000	26, 388	25, 049	1, 339	5. 1
$100,000	66, 798	63, 438	3, 360	5. 0
$500,000	429, 274	407, 790	21, 484	5. 0
$1,000,000	[1] 869, 478	[2] 826, 004	43, 474	4. 5
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$144	$16	10. 0
$3,000	360	324	36	10. 0
$4,000	560	504	56	10. 0
$5,000	760	684	76	10. 0
$8,000	1, 416	1, 305	111	7. 8
$10,000	1, 888	1, 754	134	7. 1
$15,000	3, 260	3, 057	203	6. 2
$25,000	6, 724	6, 348	376	5. 6
$50,000	19, 592	18, 572	1, 020	5. 2
$100,000	52, 776	50, 097	2, 679	5. 1
$500,000	403, 548	383, 331	20, 217	5. 0
$1,000,000	858, 548	815, 581	42, 967	5. 0
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$108	$12	10. 0
$4,000	320	288	32	10. 0
$5,000	520	468	52	10. 0
$8,000	1, 152	1, 054	98	8. 5
$10,000	1, 592	1, 472	120	7. 5
$15,000	2, 900	2, 715	185	6. 4
$25,000	6, 268	5, 915	353	5. 6
$50,000	18, 884	17, 900	984	5. 2
$100,000	51, 912	49, 276	2, 636	5. 1
$500,000	402, 456	382, 293	20, 163	5. 0
$1,000,000	857, 456	814, 543	42, 913	5. 0

[1] Maximum effective rate limitation 87 percent of taxable income.
[2] Maximum effective rate limitation 82.65 percent of taxable income.

PLAN 12

This plan would provide a tax reduction in approximately 5 equal stages over a period of from 5 to 9 years. The individual rates would be reduced from a top rate of 91 percent to 42 percent and the starting rate from 20 percent to 15 percent.

The revenue loss from the reduction in the individual rates is shown in the following table:

Estimated distribution of the tax reduction under this plan

	Millions of dollars		Percentage distribution of decrease	
	First year	Full effect	First year	Full effect
Under $5,000	380	1, 888	16. 5	16. 4
$5,000 to $10,000	750	3, 614	32. 6	31. 5
Over $10,000	1, 172	5, 989	50. 9	52. 1
Total	2, 302	11, 491	100. 0	100. 0

Burden table for individuals in first year of operation of plan 12

Income before deduction for personal exemptions	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$76	$4	5.0
$2,000	280	266	14	5.0
$3,000	488	462	26	5.3
$4,000	708	667	41	5.8
$5,000	944	888	56	5.9
$8,000	1,780	1,672	108	6.1
$10,000	2,436	2,274	162	6.7
$15,000	4,448	4,108	340	7.6
$25,000	9,796	8,912	884	9.0
$50,000	26,388	23,656	2,732	10.4
$100,000	66,798	59,184	7,614	11.4
$500,000	429,274	384,148	45,126	10.5
$1,000,000	[1] 869,478	794,148	75,330	8.7
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$152	$8	5.0
$3,000	360	342	18	5.0
$4,000	560	532	28	5.0
$5,000	760	722	38	5.0
$8,000	1,416	1,334	82	5.8
$10,000	1,888	1,776	112	5.9
$15,000	3,260	3,064	196	6.0
$25,000	6,724	6,250	474	7.0
$50,000	19,592	17,824	1,768	9.0
$100,000	52,776	47,312	5,464	10.4
$500,000	403,548	358,296	45,252	11.2
$1,000,000	858,548	768,296	90,252	10.5
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$114	$6	5.0
$4,000	320	304	16	5.0
$5,000	520	494	26	5.0
$8,000	1,152	1,088	64	5.6
$10,000	1,592	1,498	94	5.9
$15,000	2,900	2,728	172	5.9
$25,000	6,268	5,830	438	7.0
$50,000	18,884	17,188	1,696	9.0
$100,000	51,912	46,544	5,368	10.3
$500,000	402,456	357,312	45,144	11.2
$1,000,000	857,456	767,312	90,144	10.5

[1] Maximum effective rate limitation 87 percent of taxable income.

Burden table for individuals when plan 12 is fully operative

Income before deduction for personal exemptions	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$60	$20	25. 0
$2,000	280	210	70	25. 0
$3,000	488	364	124	25. 4
$4,000	708	524	184	26. 0
$5,000	944	688	256	27. 1
$8,000	1, 780	1, 212	568	31. 9
$10,000	2, 436	1, 586	850	34. 9
$15,000	4, 448	2, 608	1, 840	41. 4
$25,000	9, 796	5, 024	4, 772	48. 7
$50,000	26, 388	12, 100	14, 288	54. 1
$100,000	66, 798	28, 664	38, 134	57. 1
$500,000	429, 274	193, 628	235, 646	54. 9
$1,000,000	[1] 869, 478	403, 628	465, 850	53. 6
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$120	$40	25. 0
$3,000	360	270	90	25. 0
$4,000	560	420	140	25. 0
$5,000	760	570	190	25. 0
$8,000	1, 416	1, 048	368	26. 0
$10,000	1, 888	1, 376	512	27. 1
$15,000	3, 260	2, 244	1, 016	31. 2
$25,000	6, 724	4, 160	2, 564	38. 1
$50,000	19, 592	10, 048	9, 544	48. 7
$100,000	52, 776	24, 200	28, 576	54. 1
$500,000	403, 548	177, 256	226, 292	56. 1
$1,000,000	858, 548	387, 256	471, 292	54. 9
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$90	$30	25. 0
$4,000	320	240	80	25. 0
$5,000	520	390	130	25. 0
$8,000	1, 152	856	296	25. 7
$10,000	1, 592	1, 176	416	26. 1
$15,000	2, 900	2, 028	872	30. 1
$25,000	6, 268	3, 920	2, 348	37. 5
$50,000	18, 884	9, 736	9, 148	48. 4
$100,000	51, 912	23, 840	28, 072	54. 1
$500,000	402, 456	176, 752	225, 704	56. 1
$1,000,000	857, 456	386, 752	470, 704	54. 9

[1] Maximum effective rate limitation 87 percent of taxable income.

D. Earned Income

PLAN 13

Plan 13 provides for a tax credit of 3 percent on the portion of taxable income considered as earned. A taxpayer with all income from wages would receive 3 percent tax credit on total taxable income. All income under $5,000 is considered earned whether earned or not. This is necessary because of the tax table. Apart from this limitation earned income would be defined as now provided for in section 911 (b) of the Internal Revenue Code of 1954.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	1, 107	28. 1
$5,000 to $10,000	1, 925	48. 8
Over $10,000	913	23. 1
Total	3, 945	100. 0

Burden table for plan 13

Income before deduction for personal exemptions [1]	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$68	$12	15. 0
$2,000	280	238	42	15. 0
$3,000	488	416	72	14. 8
$4,000	708	606	102	14. 4
$5,000	944	812	132	14. 0
$8,000	1, 780	1, 558	222	12. 5
$10,000	2, 436	2, 154	282	11. 6
$15,000	4, 448	4, 016	432	9. 7
$25,000	9, 796	9, 064	732	7. 5
$50,000	26, 388	24, 906	1, 482	5. 6
$100,000	66, 798	63, 816	2, 982	4. 5
$500,000	429, 274	414, 292	14, 982	3. 5
$1,000,000	[2] 869, 478	839, 496	29, 982	3. 4
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$136	$24	15. 0
$3,000	360	306	54	15. 0
$4,000	560	476	84	15. 0
$5,000	760	646	114	15. 0
$8,000	1, 416	1, 212	204	14. 4
$10,000	1, 888	1, 624	264	14. 0
$15,000	3, 260	2, 846	414	12. 7
$25,000	6, 724	6, 010	714	10. 6
$50,000	19, 592	18, 128	1, 464	7. 5
$100,000	52, 776	49, 812	2, 964	5. 6
$500,000	403, 548	388, 584	14, 964	3. 7
$1,000,000	858, 548	828, 584	29, 964	3. 5
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$102	$18	15. 0
$4,000	320	272	48	15. 0
$5,000	520	442	78	15. 0
$8,000	1, 152	984	168	14. 6
$10,000	1, 592	1, 364	228	14. 3
$15,000	2, 900	2, 522	378	13. 0
$25,000	6, 268	5, 590	678	10. 8
$50,000	18, 884	17, 456	1, 428	7. 6
$100,000	51, 912	48, 984	2, 928	5. 6
$500,000	402, 456	387, 528	14, 928	3. 7
$1,000,000	857, 456	827, 528	29, 928	3. 5

[1] Assumed all income earned.
[2] Maximum effective rate limitation 87 percent of taxable income.

E. Optional Standard Deduction

PLAN 14

Plan 14 would increase the present 10-percent optional standard deduction to 15 percent and increase the maximum standard deduction of $1,000 to $1,500.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	648	36. 9
$5,000 to $10,000	864	49. 3
Over $10,000	242	13. 8
Total	1, 754	100. 0

Burden table for plan 14

Income before deduction for personal exemptions [1]	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$69	$10	12. 6
$2,000	280	258	22	7. 9
$3,000	488	451	37	7. 6
$4,000	708	659	49	6. 9
$5,000	944	872	72	7. 6
$8,000	1, 780	1, 647	133	7. 5
$10,000	2, 436	2, 266	170	7. 0
$15,000	4, 448	4, 217	231	5. 2
$25,000	9, 796	9, 501	295	3. 0
$50,000	26, 388	26, 028	360	1. 4
$100,000	66, 798	66, 363	435	. 7
$500,000	429, 274	428, 819	455	. 1
$1,000,000	[2] 869, 478	[2] 869, 043	435	. 1
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$138	$22	13. 9
$3,000	360	327	33	9. 3
$4,000	560	516	44	7. 9
$5,000	760	704	56	7. 3
$8,000	1, 416	1, 318	98	6. 9
$10,000	1, 888	1, 758	130	6. 9
$15,000	3, 260	3, 110	150	4. 6
$25,000	6, 724	6, 534	190	2. 8
$50,000	19, 592	19, 297	295	1. 5
$100,000	52, 776	52, 416	360	. 7
$500,000	403, 548	403, 093	455	. 1
$1,000,000	858, 548	858, 093	455	. 1
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$87	$33	27. 8
$4,000	320	276	44	13. 9
$5,000	520	464	56	10. 7
$8,000	1, 152	1, 054	98	8. 5
$10,000	1, 592	1, 482	110	6. 9
$15,000	2, 900	2, 750	150	5. 2
$25,000	6, 268	6, 078	190	3. 0
$50,000	18, 884	18, 589	295	1. 6
$100,000	51, 912	51, 552	360	. 7
$500,000	402, 456	402, 001	455	. 1
$1,000,000	857, 456	857, 001	455	. 1

[1] Assumes that the standard deduction is taken by all taxpayers.
[2] Maximum effective rate limitation 87 percent of taxable income.

PLAN 15

Plan 15 would provide a minimum standard deduction of $500. Under present law a taxpayer may elect the optional standard deduction of approximately 10 percent of his adjusted gross income. This is in lieu of itemizing his personal deductions, such as medical expenses, charitable contributions, and interest on personal indebtedness. For a taxpayer with $3,000 of wages and salaries the present standard deduction is $300. Under the plan the standard deduction would be increased to $500. A taxpayer with a $2,000 salary receives under present law a $200 standard deduction and under the plan he would receive $500. A taxpayer with a salary of $5,000 receives a standard deduction of $500 under present law and this would remain the same under the plan. For incomes above $5,000 this plan would provide no relief. There would be 3,900,000 taxpayers relieved of all tax liability and the plan would result in a revenue loss of $880 million with the entire amount of this reduction going to taxpayers under $5,000.

PLAN 16

Plan 16 would provide a minimum standard deduction of $500 and in addition give all taxpayers a 5-percent reduction in tax. Under present law a taxpayer may elect the optional standard deduction of approximately 10 percent of his adjusted gross income in lieu of itemizing his personal deductions such as medical expenses, charitable contributions, and interest on personal indebtedness. For a taxpayer with $3,000 of wages and salaries the present standard deduction is $300. Under the plan his standard deduction would be $500. The $2,000 salary receives a standard deduction of $200 and under the plan it would be $500. At a salary of $5,000 and above no benefit would be received from the minimum standard deduction but these taxpayers would receive the 5-percent reduction in tax. There would be 3,900,000 taxpayers relieved of all tax liability under this plan.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	1, 207	45. 3
$5,000 to $10,000	706	26. 5
Over $10,000	752	28. 2
Total	2, 665	100. 0

Burden table for plan 16

Income before deduction for personal exemptions [1]	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$2	$78	97.2
$2,000	280	213	67	23.9
$3,000	488	429	59	12.1
$4,000	708	661	47	6.6
$5,000	944	897	47	5.0
$8,000	1,780	1,691	89	5.0
$10,000	2,436	2,314	122	5.0
$15,000	4,448	4,226	222	5.0
$25,000	9,796	9,306	490	5.0
$50,000	26,388	25,069	1,319	5.0
$100,000	66,798	63,458	3,340	5.0
$500,000	429,274	407,810	21,464	5.0
$1,000,000	[2] 869,478	840,060	29,418	3.4
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$99	$61	38.0
$3,000	360	310	50	13.8
$4,000	560	521	39	6.9
$5,000	760	722	38	5.0
$8,000	1,416	1,345	71	5.0
$10,000	1,888	1,794	94	5.0
$15,000	3,260	3,097	163	5.0
$25,000	6,724	6,388	336	5.0
$50,000	19,592	18,612	980	5.0
$100,000	52,776	50,137	2,639	5.0
$500,000	403,548	383,371	20,177	5.0
$1,000,000	858,548	815,621	42,927	5.0
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$82	$38	31.4
$4,000	320	293	27	8.3
$5,000	520	494	26	5.0
$8,000	1,152	1,094	58	5.0
$10,000	1,592	1,512	80	5.0
$15,000	2,900	2,755	145	5.0
$25,000	6,268	5,955	313	5.0
$50,000	18,884	17,940	944	5.0
$100,000	51,912	49,316	2,596	5.0
$500,000	402,456	382,333	20,123	5.0
$1,000,000	857,456	814,583	42,873	5.0

[1] Assumes that the standard deduction is taken by all taxpayers.
[2] Maximum effective rate limitation 87 percent of taxable income.

PLAN 17

Plan 17 would increase the 10 percent optional standard deduction to 15 percent and raise the maximum standard deduction from $1,000 to $1,500. In addition there would be a 5-percent reduction in the tax payable.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	987	28. 2
$5,000 to $10,000	1, 527	43. 7
Over $10,000	982	28. 1
Total	3, 486	100. 0

Burden table for plan 17

Income before deduction for personal exemptions[1]	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$65	$15	18. 2
$2,000	280	245	35	12. 5
$3,000	488	429	59	12. 1
$4,000	708	626	82	11. 6
$5,000	944	828	116	12. 3
$8,000	1, 780	1, 564	216	12. 1
$10,000	2, 436	2, 153	283	11. 6
$15,000	4, 448	4, 006	442	9. 9
$25,000	9, 796	9, 026	770	7. 9
$50,000	26, 388	24, 727	1, 661	6. 3
$100,000	66, 798	63, 045	3, 753	5. 6
$500,000	429, 274	407, 378	21, 896	5. 1
$1,000,000	[2] 869, 478	839, 628	29, 850	3. 4
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$131	$29	18. 2
$3,000	360	310	50	13. 8
$4,000	560	490	70	12. 5
$5,000	760	669	91	11. 9
$8,000	1, 416	1, 252	164	11. 6
$10,000	1, 888	1, 670	218	11. 5
$15,000	3, 260	2, 955	305	9. 4
$25,000	6, 724	6, 207	517	7. 7
$50,000	19, 592	18, 332	1, 260	6. 4
$100,000	52, 776	49, 795	2, 981	5. 6
$500,000	403, 548	382, 938	20, 610	5. 1
$1,000,000	858, 548	815, 188	43, 360	5. 1
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$82	$38	31. 4
$4,000	320	262	58	18. 2
$5,000	520	441	79	15. 3
$8,000	1, 152	1, 001	151	13. 1
$10,000	1, 592	1, 408	184	11. 6
$15,000	2, 900	2, 613	287	9. 9
$25,00	6, 268	5, 774	494	7. 9
$50,000	18, 884	17, 660	1, 224	6. 5
$100,0000	51, 912	48, 974	2, 938	5. 7
$500,000	402, 456	381, 901	20, 555	5. 1
$1,000,000	857, 456	814, 151	43, 305	5. 1

[1] Assumes that the standard deduction is taken by all taxpayers.
[2] Maximum effective rate limitation 87 percent of taxable income.

PLAN 18

Plan 18 would increase the present 10 percent optional standard deduction to 15 percent and raise the maximum limitation from $1,000 to $1,500 with the proviso that each taxpayer would receive at least a minimum standard deduction of $500. In addition there would be a 5-percent reduction in the tax payable. This would relieve an estimated 3,900,000 taxpayers of all tax liability.

Estimated distribution of the tax reduction under this plan

	Millions of dollars	Percentage distribution of decrease
Under $5,000	1, 407	35. 9
$5,000 to $10,000	1, 527	39. 0
Over $10,000	982	25. 1
Total	3, 916	100. 0

Burden table for plan 18

Income before deduction for personal exemptions [1]	Present law tax	Plan tax	Reduction	
			Amount	Percent
SINGLE PERSON—NO DEPENDENTS				
$1,000	$80	$2	$78	97. 4
$2,000	280	213	67	23. 9
$3,000	488	429	59	12. 1
$4,000	708	626	82	11. 6
$5,000	944	828	116	12. 3
$8,000	1, 780	1, 564	216	12. 1
$10,000	2, 436	2, 153	283	11. 6
$15,000	4, 448	4, 006	442	9. 9
$25,000	9, 796	9, 026	770	7. 9
$50,000	26, 388	24, 727	1, 661	6. 3
$100,000	66, 798	63, 045	3, 753	5. 6
$500,000	429, 274	407, 378	21, 896	5. 1
$1,000,000	[2] 869, 478	839, 628	29, 850	3. 4
MARRIED COUPLE—NO DEPENDENTS				
$2,000	$160	$99	$61	38. 0
$3,000	360	310	50	13. 8
$4,000	560	490	70	12. 5
$5,000	760	669	91	11. 9
$8,000	1, 416	1, 252	164	11. 6
$10,000	1, 888	1, 670	218	11. 5
$15,000	3, 260	2, 955	305	9. 4
$25,000	6, 724	6, 207	517	7. 7
$50,000	19, 592	18, 332	1, 260	6. 4
$100,000	52, 776	49, 795	2, 981	5. 6
$500,000	403, 548	382, 938	20, 610	5. 1
$1,000,000	858, 548	815, 188	43, 360	5. 1
MARRIED COUPLE—2 DEPENDENTS				
$3,000	$120	$82	$38	31. 4
$4,000	320	262	58	18. 2
$5,000	520	441	79	15. 3
$8,000	1, 152	1, 001	151	13. 1
$10,000	1, 592	1, 408	184	11. 6
$15,000	2, 900	2, 613	287	9. 9
$25,000	6, 268	5, 774	494	7. 9
$50,000	18, 884	17, 660	1, 224	6. 5
$100,000	51, 912	48, 974	2, 938	5. 7
$500,000	402, 456	381, 901	20, 555	5. 1
$1,000,000	857, 456	814, 151	43, 305	5. 1

[1] Assumes that the standard deduction is taken by all taxpayers.
[2] Maximum effective rate limitation 87 percent of taxable income.

O

PREFACE

This report deals with the question of whether or not it was proper for the Internal Revenue Service to allow the Arabian American Oil Co. (Aramco) a foreign tax credit with respect to certain specialized levies on income enacted by Saudi Arabia in 1950. This problem has received widespread attention because the foreign tax credit virtually eliminated the substantial United States taxes that had been paid by Aramco prior to 1950. The widespread attention given the problem resulted in some discussion of it during hearings on the oil for Europe program held jointly in March of 1957 by the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary and the Subcommittee on Public Lands of the Senate Committee on Interior and Insular Affairs. As a result of these hearings the Judiciary Committee called this problem to the attention of the Committee on Finance which requested this report from the staff of the Joint Committee on Internal Revenue Taxation.

This report is made to the Committee on Finance on the basis of confidential information collected by the staff. These sources include the tax returns of Aramco, the basic agreements between Aramco and Saudi Arabia, internal memorandums of the Treasury and the taxpayer, and discussions by the staff with the taxpayer, and with the Assistant Commissioner (Technical) and the Chief Counsel of the Internal Revenue Service. Since this report includes data from tax returns and other confidential information, the law requires that it be considered by the Finance Committee only in executive session (sec. 6103 of the Internal Revenue Code). It may be released to the public only to the extent that it is contained in a report of the Finance Committee to the Senate.

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A REPORT ON THE FOREIGN TAX CREDIT PROBLEM OF THE ARABIAN AMERICAN OIL CO. (ARAMCO)

I. The Issue

The problem at issue is whether or not an exaction imposed by Saudi Arabia on companies producing oil is eligible for the foreign tax credit under section 901 of the Internal Revenue Code. The problem has arisen because of various circumstances which suggest that the so-called income tax may be in substance a disguised royalty which would be a deduction against income rather than a credit against tax.

The Internal Revenue Service ruled that the levy was eligible for the foreign tax credit (Rev. Rul. 55-296, 1955-1 CB 386).[1]

II. Statement of Facts

A. BACKGROUND MATERIAL WITH RESPECT TO ARAMCO

In 1933 the California-Arabian Standard Oil Co., a subsidiary of Standard Oil of California, entered into an agreement with the Government of Saudi Arabia, conveying oil rights to the company for 60 years.[2] These were full drilling rights in a large area of the country and a preference for obtaining concessions in other areas, including the so-called neutral zones. In return the company agreed to a royalty of 4 shillings gold per ton plus certain advance payments on its part; the Government agreed, among other things, that the—

> * * * company and enterprise shall be exempt from all direct and indirect taxes, imposts, charges, fees, and duties (including, of course, import and export duties) * * * (art. 21).

Oil was discovered in commercial quantities in 1938. A new agreement in 1939 extended the concession area and continued the concession for 60 years from 1939.[3] In 1936 a half interest in the Arabian subsidiary was sold by Standard Oil of California to the Texas Oil Co. for which the Texas company agreed to pay $21 million.[4] In 1947 a 30 percent interest was sold to Standard Oil of New Jersey and a 10 percent interest to Socony-Vacuum for $102 million.[5] This price for a 40-percent interest would imply a total value in 1946 when the sale was negotiated of $255 million. Actually the 40 percent share was probably worth more than the $102 million since the sale made it possible for Aramco to participate in the established marketing outlets of Standard of New Jersey and Socony.[6]

The present name, Arabian American Oil Co. or "Aramco" was adopted in 1944. The company was at all times a United States corporation chartered under the laws of Delaware. The stock of

[1] For text of ruling, see appendix 1.
[2] For text of the 1933 agreement, see appendix 2.
[3] For text of the 1939 agreement, see appendix 2.
[4] The International Petroleum Cartel, report of the staff of the Federal Trade Commission, p. 116. Certain other interests were exchanged in the same transaction.
[5] Ibid., p. 123.
[6] Ibid., pp. 120-124.

Aramco is still held exclusively by the 4 corporations, 30 percent each by Standard Oil of California, the Texas Oil Co., and Standard Oil of New Jersey, and 10 percent by Socony-Vacuum.

B. THE CONTROVERSY OF 1949–50

In 1949 Aramco reported a net income for United States tax purposes of $114 million and a United States tax of $43 million.[7] In the same year a royalty of $37 million was paid to Saudi Arabia.[8] The fact that the United States was obtaining more revenue from the Arabian operation than was the Government of Saudi Arabia was an important element in that Government's increasing discontent with the original concession agreement. Representatives of the company stated that they explored the possibility of insisting upon fulfillment of the conditions in the concession agreement but were told by Mr. George McGhee, then in charge of Middle East affairs for the United States State Department, that longstanding contracts were subject to modification from time to time and that the Department could not take a strong stand in support of a refusal to make any change in the concession.[9]

In addition to other points in dispute Saudi Arabia insisted upon an increase in the fixed royalty per ton, a share in the profits, and an abrogation of the old tax concession.[10] Accordingly it is clear that Saudi Arabia believed that it was entitled to receive larger payments for its oil, whatever form these payments might take. This is further borne out by the reference to the fact that another American company was required to make relatively larger payments for a concession in the Kuwait neutral zone.[11]

C. THE 1950 TAXES OF SAUDI ARABIA

By royal decree No. 17/2/28/3321/21 dated November 4, 1950,[12] a general tax of 20 percent was imposed on the net profits of companies, and also certain other taxes on individuals. Generally, the decree allowed companies a deduction for business expenses but no deduction for percentage depletion. Thus, in terms of the United States definition of income in the case of an oil company, the effective rate was close to 28 percent. For convenience this tax will hereafter be called the November tax.

By royal decree No. 17/2/28/7634/16 dated December 22, 1950,[13] a special tax was imposed on the income of companies producing petroleum and other hydrocarbon products. Generally the tax was designed to assure the Government of Saudi Arabia a 50 percent share in profits from oil. The decree imposed a tentative tax of 50 percent of net income computed with no deduction for percentage depletion and with no deduction for royalties, taxes and other amounts paid to Saudi Arabia. Then royalties and taxes, etc., were allowed as

[7] Tax return of Arabian American Oil Co. for calendar year 1949.
[8] Ibid., schedule A.
[9] Memorandum from Mr. Douglas Erskine, manager, tax division, Aramco, to Mr. A. Frederick Olsen, special adviser, Internal Revenue Service, Office of District Director, New York, dated April 16, 1954. This is shown in appendix 6.
[10] Letter from Abdullah Essuleiman, Minister of Finance to representatives of Arabian American Oil Co., September 5, 1950, reproduced in appendix 4.
[11] Letter from A. Essuleiman to representatives of Aramco, August 20, 1950, reproduced in appendix 4. This staff understood in conversation with Mr. Douglas Erskine that this royalty rate imposed on two other companies is somewhat more than twice the royalty rate imposed on Aramco.
[12] For text, see appendix 3.
[13] For text, see appendix 3.

credits against the tentative tax. One result of this arrangement was that any increase in the royalty paid, or in the rate of the November tax would reduce the liability under the December tax by the same amount. This tax will hereafter be called the December tax.

On December 10, 1950, the Government of Saudi Arabia entered a formal agreement with Aramco modifying the original 1933 concession agreement.[14] In the 1950 modification Aramco gave up its original tax exemption and was given instead a commitment that royalties, rentals, Saudi taxes and other exactions would not exceed 50 percent of "the gross income of Aramco, after such gross income has been reduced by Aramco's cost of operation, including losses and depreciation, and by income taxes, if any, payable to any foreign country, but not reduced by any taxes, royalties, rentals, or other exactions of the Government for such year." In addition the new agreement confirmed the basic oil rights of Aramco and settled certain other matters in controversy, including the exchange rate at which the 4 shillings gold per ton royalty was to be determined.

Since 1950 two significant changes have been enacted in the November tax. Saudi nationals and companies all the partners or shareholders of which were Saudi nationals were exempted from the tax, at least partly in consideration of religious taxes imposed on them. This restricts the November tax to foreign companies but would not appear to affect the allowability of the foreign tax credit in the case of this tax since there are a large number of foreign companies that do pay the tax. In Royal Decree No. 17/2/28/576, dated October 19, 1956,[15] the rate of the November tax was modified in favor of a progressive structure reaching 40 percent on income above 1 million riyals. Since no percentage depletion is allowed under this tax this is equivalent to a rate somewhat over 55 percent in terms of the United States concept of net income. Thus in the future the tax paid under the November decree should exceed the United States tax and the question of a credit for the December tax is likely to be of no importance since this tax probably will no longer apply.

The effect of the steps taken by Saudi Arabia in 1950 was to obtain for it the additional payments it sought, while at the same time accommodating Aramco by exacting the additional amounts in the form of taxes which may be credited against the United States tax. If these exactions were royalties they could only be deducted from United States income. Information as to the difference in result was available to Saudi Arabia from several sources. Venezuela had devised a similar tax on oil companies, which had been held eligible for the United States foreign tax credit (IT 4038, 1950–2 C. B. 54). A Saudi delegation had visited Venezuela to study their administration of oil properties.[16] Certain Saudi Government officials, on their own initiative, also discussed the effect of this treatment with Mr. George Eddy, a United States Treasury official, sent to Saudi Arabia in 1949 as an adviser on monetary affairs.[17] During the negotiations, when the company consulted with the State Department they were told by Mr. McGhee, then in charge of the Middle East affairs for the United States State Department, that he hoped that in the interests of Middle East relations generally the matter could be

[14] For text of 1950 agreement, see appendix 2.
[15] For text, see appendix 3.
[16] Memorandum, Erskine to Olsen, cited previously.
[17] Mr. Eddy testified to this effect in the O'Mahoney hearings, pp. 1445–1446.

settled by means other than by adjusting the royalty rate. He suggested the Venezuela pattern as less disturbing.[18]

The board of directors of Aramco issued an authorization to management dated November 14, 1950, stating that management is authorized to attempt a settlement, submitting if necessary to new income taxes provided that the taxes and royalties would not exceed 50 percent of net income. The fact is that at this point the management of Aramco had almost no alternative. It could have refused to pay the Saudi taxes and taken the matter to the World Court on the basis of the 1933 concession. Even if this were successful Aramco would still have risked retaliation by the Saudi Government, perhaps even nationalization.

Saudi Arabia hired a Washington tax attorney, Mr. John Greaney, to prepare a first draft of the November tax decree. The first draft of the December decree was prepared by officials of Aramco.[19]

D. HANDLING OF THE CASE IN THE UNITED STATES TREASURY

The following summary of the handling of the Aramco case within the United States Treasury Department is based principally on a memorandum of November 22, 1954, prepared in the Office of the Chief Counsel, Internal Revenue Service. The principal papers referred to were made available to the staff.

On June 16, 1951, the Office of Financial and Development Policy of the State Department requested the views of the Office of International Finance of Treasury on the subject of allowable tax credits for payments by United States companies in the Middle East pursuant to profit-sharing formulas, with particular reference to Aramco. Within a few weeks a letter indicating that a tax credit was allowable in this case was prepared in the Chief Counsel's Office and referred to the Commissioner. Discussion with Treasury ensued. On December 7, 1951, a letter from the General Counsel of the Treasury requested reconsideration by Internal Revenue. A memorandum of authorities was prepared in the Chief Counsel's Office and forwarded to the Deputy Commissioner on March 12, 1952, and to the General Counsel of Treasury on March 27.

On November 12, 1952, the Tax Legislative Counsel of the Treasury addressed a memorandum to the Chief Counsel, Internal Revenue, requesting a conference on the ruling and attaching a memorandum prepared in the Tax Legislative Counsel's office raising the point that payments under the December decree might be regarded as a disguised royalty. The conference held December 22, 1952, reached the conclusion that no ruling should be issued at that time.

A memorandum from the new Tax Legislative Counsel of the Treasury to Chief Counsel, Internal Revenue, on September 28, 1953, asked for a further reconsideration. At this time the State Department only expressed its desire of being advised ahead of time if it was decided to hold adversely to the oil companies. During this series of discussions in Washington the audit of the tax return of Aramco for 1950 was begin in the office of the Director of Internal Revenue, New York. As a result it was agreed to postpone further Washington discussion pending the field examination, and to request the New York office to notify the Washington office of any proposed action on this matter.

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[18] Memorandum, Erskine to Olsen, cited previously.
[19] *Ibid.*

In response to the Washington request the District Director, Upper Manhattan district, submitted a copy of a memorandum dated April 19, 1954, by an internal revenue agent, having the status of a special adviser, concluding that a tax credit was allowable.

After a review of the findings of the New York office and after the case was reviewed by the Chief Counsel's Office, the Internal Revenue Service issued a ruling favorable to the taxpayer and confirming the action proposed by the field office [20] (this ruling was subsequently published as Rev. Rul. 55–296, 1955–1, C. B. 386 which is shown in appendix 1).

E. FINANCIAL DATA ON ARAMCO OPERATIONS

Table 1 summarizes Aramco's tax computations for 1955. It shows that in 1955 Aramco had gross sales of $698 million under United States concepts of income and $723 million under Saudi Arabian concepts. The former resulted in a tax base of $340 million for the United States tax and the latter a tax base of $465 million for the Saudi Arabian November 1950 levy. Thus, primarily because of the deduction for percentage depletion, the deductions allowed from gross sales by the United States are substantially larger than those allowed by Saudi Arabia. The tax base of the December 1950 levy is larger than that for the November levy by the amount of the royalties which together with taxes, etc., are credited against this tax rather than deducted from it.

As can be seen from table 2 the amount in dispute in this tax question, for 1955 alone, is a possible additional United States tax of $45 million which would result from treating payments to Saudi Arabia of $100 million under the December decree as a royalty instead of a tax.

Basically this difference arises because foreign income taxes may be taken as credits against tax while other costs are merely taken as deductions from income. Take for example a company with an income of $100,000 from a foreign source which was subject to a foreign income tax of 52 percent. Since the United States tax on this income would also be $52,000 (for convenience the surtax exemption is ignored) a tax credit for this foreign tax would completely eliminate the United States tax. However, if the $52,000 foreign tax had been allowed as a deduction instead of a credit, the United States tax would not be eliminated. Instead, the $100,000 income would be reduced by the deduction of $52,000 for the foreign tax leaving a taxable income of $48,000. A 52 percent tax on $48,000 would amount to $24,960. In the case in question, however, it is necessary to modify this conclusion somewhat because the designation of the "tax" as a "royalty" would reduce the base to which the 27½ percent depletion allowance is applied. Because of this, treating an amount as a deduction rather than a credit would reduce the percentage depletion allowance by 27½ percent of the amount treated as a "royalty" rather than a "tax." On the other hand, however, in the case of Aramco the taxes paid to Saudi Arabia exceed slightly the amount which can be claimed as a credit against United States tax.

By a decree of October 19, 1956, the rate of tax under the general tax provision, the November tax, has been raised to 40 percent on income over 1 million riyals. (A riyal is worth about $0.27.) This

[20] Appendix 5 contains a letter written on the Aramco case by the Assistant Commissioner (Technical) to the New York office, together with a letter from the Chief Counsel's Office expressing the views of this office on an earlier draft of this letter. It also contains the memorandum, referred to above, prepared in the Office of the Tax Legislative Counsel of the Treasury and sent to the Chief Counsel on November 12, 1952.

in effect nearly doubles the tax paid under the November decree for Aramco. It is easily seen from table 1 that, as applied to 1955 figures, a doubling of the November tax amount would produce a tax of $186 million, or $9 million more than the United States tax liability. This alone would provide more foreign taxes than the company would need to eliminate its United States tax. Thus, the eligibility of the December tax for the credit appears to be of no significance for the future.

Table 3 summarizes the pertinent data with respect to the computation of Aramco's taxes for the period 1945–55.

TABLE 1.—*Summary derivation of taxes paid by Aramco for 1955*

[Millions]

(*a*) United States taxes:	
Gross sales	$698
Less:	
Cost of goods sold other than royalty	100
Royalty	78
Percentage depletion [1]	148
Depreciation	20
Other deductions	12
Subtotal	358
Taxable income	340
Income tax before foreign tax credit	177
Foreign tax credit [2]	193
Net United States tax	0
(*b*) Saudi Arabian taxes:	
Gross sales	[3] 723
Less: royalties	78
Other deductions	180
Subtotal	258
Net income	465
Income tax under November decree (20 percent of net income)	93
Income tax under December decree:	
Net income	465
Plus royalty	78
Net operating income	543
Tentative tax (50 percent of net operating income)	271
Less November decree tax	93
Royalty	78
Other duties, etc	([4])
Subtotal	171
Additional tax under December decree	100
Total Saudi Arabian taxes	193

[1] After allocating some income and royalty to the pipeline operations of Aramco, the gross income from the property was $615,000,000 less allocable royalty of $76,000,000 or $539,000,000 of which $148,000,000 is 27½ percent.

[2] About ½ million dollars in interest was received from United States sources but this was washed out by deductions for contributions. Thus the percentage limitation on the foreign tax credit is not applicable.

[3] The taxpayer's summary of the Saudi tax for 1955 indicates that under Saudi law a higher figure of gross sales had to be reported than under United States law.

[4] Less than 1,000,000.

Source: United States tax return of Aramco for 1955.

TABLE 2.—*Hypothetical calculation of United States taxes on Aramco for 1955 income assuming that the amount paid under the December decree is treated as a royalty*

[Millions]

Gross sales	$698
Less cost of goods sold other than royalty	100
Royalty	178
Percentage depletion [1]	122
Depreciation	20
Other deductions	12
Subtotal	432
Taxable income	266
Income tax	138
Foreign tax credit	93
Net United States tax	45

[1] Gross income from property still assumed to be $615,000,000 and the allocable royalty is assumed to be 97 percent of the actual royalty, $78,000,000, plus the December tax of $100,000,000, or $172,000,000.

TABLE 3.—*Selected financial data relating to Aramco*

[Millions]

Year	Net or taxable income	United States tax liability before credit	Foreign tax credit	United States income tax assessed	Royalty paid	United States percentage depletion deduction
1945	$2.8	$1.1	0	$1.1	(1)	(1)
1946	24.4	9.3	0	9.3	(1)	(1)
1947	49.9	18.9	0	18.9	(1)	(1)
1948	73.9	28.1	0	28.1	(1)	(1)
1949	113.8	43.3	0	43.3	$37.1	59.8
1950	110.1	46.2	$46.0	.2	42.7	62.0
1951	194.9	98.9	98.6	.3	59.6	84.4
1952	200.1	103.9	103.3	.6	67.0	91.9
1953	213.6	111.0	111.0	0	68.6	98.8
1954	267.9	139.3	139.3	0	77.3	119.3
1955	339.8	176.7	176.7	0	78.3	148.2

[1] Not available.

Source: 1949–55 United States tax returns of Aramco; 1945–48 Internal Revenue Service Memorandum, Nov. 22, 1954.

III. ANALYSIS OF THE LAW

A. STATUTORY PROVISIONS

Corporations organized in the United States are subject to the United States income tax upon all of their income, whether derived from domestic sources or from foreign sources. In addition, income from sources without the United States generally is subject to taxation by the foreign country from which the income is derived. Taxes paid or accrued to the foreign country may be taken into account by the taxpayer, in computing his United States tax liability, in either of two ways: (1) the taxpayer may deduct the foreign taxes in computing his taxable income;[21] or (2) the taxpayer may credit against his United States income tax "the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any

[21] The deduction is provided for in sec. 164 of the 1954 Code and in sec. 23 (c) (1) of the 1939 Code.

foreign country or to any possession of the United States." [22] The terms "taxes" and "income taxes" are not defined in the statute.

Where the taxpayer chooses to deduct the foreign tax, the foreign taxes are treated in the same manner as any other deduction. The amount of the taxable income is determined by subtracting from the gross income the amount of foreign taxes plus all other allowable deductions. Where the taxpayer chooses to take the foreign tax credit the foreign taxes may not be deducted. Instead, the United States income tax is reduced, subject to certain limitations, by the amount of the foreign tax.

Generally, it is more advantageous for a taxpayer to take the foreign tax credit, since the credit allows the reduction of the United States tax (computed on the basis of the taxpayer's income from all sources and computed without regard to any foreign income taxes that may have been paid on it) on a dollar-for-dollar basis, whereas the use of the foreign taxes as a deduction in effect permits a reduction of the tax by only a fraction of such amount, the amount of the reduction depending upon the marginal tax rate of the taxpayer involved.

While the foreign tax credit is generally preferable to the deduction for foreign taxes, nevertheless there are limits upon the effect of the credit. The first is implicit in the credit device. Since the foreign income is subject to United States tax and the credit operates to reduce that tax by only the amount of the foreign taxes paid, if the foreign rate is less than the United States rate a United States tax is imposed upon the difference. The second is stated expressly in the law.[23] In general, this limitation is effective where the foreign rate of tax exceeds the United States rate. In such case, the limitation prevents the credit from exceeding the tax that would have been paid to the United States had the income been taxed only at United States income tax rates. The effect of this limitation, as applied to the income from any particular foreign country, is to prevent the foreign tax credit from reducing the taxpayer's United States income tax upon either his United States income or his income from any other foreign country.

Although the foreign tax credit may not reduce the taxpayer's United States income tax upon his income from sources other than the particular foreign country, where the foreign operations of a taxpayer produce a loss they will affect the taxpayer's United States income tax entirely apart from the credit. For example, where a United States corporation has income in the United States but a loss

[22] The credit is provided for in sec. 901 of the 1954 Code and in sec. 131 (a) of the 1939 Code. No substantive change was made by the 1954 Code. The relevant passages of sec. 901 of the 1954 Code are as follows:

"SEC. 901. TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES.

"(a) Allowance of Credit.—If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under section 902. Such choice may be made or changed at any time prior to the expiration of the period prescribed for making a claim for credit or refund of the tax against which the credit is allowable. The credit shall not be allowed against the tax imposed by section 531 (relating to the tax on accumulated earnings), against the additional tax imposed for the taxable year under section 1333 (relating to war loss recoveries), or against the personal holding company tax imposed by section 541.

"(b) Amount Allowed.—Subject to the limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

"(1) Citizens and Domestic Corporations.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and * * *"

[23] This limitation was contained in sec. 131 (b) (1) of the 1939 Code and reenacted as sec. 904 of the 1954 Code. It is popularly called the "per country" limitation. It restricts the foreign tax which can be claimed as a credit to an amount which is the same proportion of the taxpayer's total United States tax liability before credit as his taxable income from the foreign country bears to his total taxable income. Sec. 131 (b) (2) of the 1939 Code also contained an "overall" limitation computed with reference to the taxpayer's net income from all sources without the United States. This limitation was eliminated in the 1954 Code revision.

in the foreign country, the foreign loss will be taken into account in computing the taxpayer's United States income tax (in the same manner as any income from the foreign country would have been taken into account in determining the United States tax). If the taxpayer operates in more than 1 foreign country, losses in 1 country may have the effect of reducing the taxpayer's United States tax even though the taxpayer has a profit in another country and claims the foreign tax credit with respect to the foreign taxes paid that country.[24]

B. LEGISLATIVE HISTORY

The foreign tax credit was introduced in the Revenue Act of 1918.[25] Prior to that act, foreign taxes were treated as deductible expenses, in the same manner as State and local taxes. The report of the Committee on Ways and Means gave the following reasons for the adoption of the credit:

> Under existing law a citizen of the United States can only deduct income war or excess profits taxes paid to a foreign country from gross income in computing net income. With the corresponding high rates imposed by certain foreign countries the taxes levied in such countries in addition to the taxes levied in the United States upon citizens of the United States place a very severe burden upon such citizens. The bill provides that a credit against the income tax imposed in the United States be allowed a citizen of the United States subject to income and war or excess profits taxes in a foreign country of an amount equal to the tax paid in such country. * * *[26]

During the course of the House debate on the Revenue Act of 1918, Mr. Claude Kitchin, chairman of the Committee on Ways and Means, commented further upon the purposes of this provision:

> That is not only a just provision, but a very wise one. It is wise from the standpoint of the commerce of the United States, of the expansion of business of the United States. * * * We would discourage men from going out after commerce and business in different countries or residing for such purposes in different countries if we maintained this double taxation. They would take their corporations that are American corporations and reorganize them, getting their charters in such foreign countries, if we did not do this, and we might not be able to tax their income and profits at all. * * *[27]

The foreign tax credit has been a part of the United States revenue laws since its introduction in 1918. On at least two occasions (1932 and 1934) proposals to eliminate the provision were defeated. On both occasions the proponents of the credit stressed the necessity of the credit to avoid double taxation and to encourage foreign trade.[28] Thus, in 1934, when a subcommittee of the Committee on Ways and Means recommended the complete elimination of the foreign tax credit, the report of the full committee noted that the Treasury Department—

> * * * was of the opinion that the present method was fair and should be continued, pointing out that "the United States, to avoid burdensome double taxation and to encourage foreign trade, should therefore allow an offsetting credit against its own income tax." [29]

[24] If the taxpayer's losses, domestic or foreign, reduce his total income from all sources to a level substantially below his foreign income, it will often be desirable for the taxpayer to choose to deduct any foreign taxes paid, since in such cases the deduction when multiplied by the United States tax rate may exceed the amount of the tax credit.
[25] Sec. 222 and 238 of the Revenue Act of 1918.
[26] H. Rept. No. 767, 65th Cong., 2d sess., p. 11.
[27] 56 Congressional Record, Appendix, 677 (1918).
[28] See, e. g., 75 Congressional Record 6490, 7049 (1932).
[29] H. Rept. No. 704, 73d Cong., 2d sess., p. 15.

The full committee rejected the subcommittee proposal but did recommend an additional limitation on the foreign tax credit which would have reduced substantially the amount of the allowable credit.[30] The Senate Committee on Finance believed this approach also placed "* * * an undue burden upon income from foreign sources" and recommended the restoration of existing law.[31] In the committee of conference the House receded to the Senate amendments restoring existing law.[32]

Since 1934 there have been a number of technical amendments to the foreign tax credit and two major extensions in its application. The technical amendments do not reveal any change of congressional policy with respect to the foreign tax credit. On the contrary, they appear to be directed toward further implementing the basic congressional policy underlying the provision. In many instances, these amendments were merely the result of changes made in other provisions of the law. [33]

The first major extension in the application of the foreign tax credit occurred with the Revenue Act of 1942.[34] That act added section 131 (h) to the 1939 Code, extending the scope of the foreign tax credit by making the credit available for "a tax paid in lieu of a tax upon income, war profits, or excess profits otherwise generally imposed by any foreign country or by any possession of the United States." This provision was reenacted as section 903 of the 1954 Code. It does not appear that either Aramco or the Internal Revenue Service has taken the position that this "in lieu of" provision is applicable to the Aramco case. The Treasury regulations clearly deny the applicability of this provision in this type of case.[35] In addition, to would appear that if a levy is not regarded as a tax under section 131 (a) (sec. 901 of the 1954 Code), it could not be regarded as a tax under section 131 (h) (sec. 903 of the 1954 Code). Accordingly, the same basic question—whether or not the levy is a tax—is presented by both provisions. The "in lieu of" provision, nevertheless, does indicate that Congress desired the foreign tax credit provision to have broad application.

The second major extension in the application of the foreign tax credit provision came about with the enactment of the Internal Revenue Code of 1954. The 1954 Code deleted the "overall" limitation in effect under the 1939 Code, the effect of which had been to limit the foreign tax credit where a taxpayer earned income in one country and incurred a loss in another. It was believed that this limitation was undesirable because it discouraged companies operating profitably in one foreign country from going into another country where it may operate at a loss for a few years.[36]

In 1954, the House of Representatives proposed additional changes with respect to the tax treatment of foreign income. The principal changes proposed were: 14-point rate reduction for certain foreign income; deferral of tax on the profits of foreign branches of domestic

[30] Ibid., p. 16.
[31] S. Rept. No. 558, 73d Cong., 2d sess., p. 39.
[32] H. Rept. No. 1385, 73d Cong., 2d sess., p. 23.
[33] Technical amendments to the foreign tax credit provision were made by sec. 341 of the Revenue Act of 1951; sec. 130 of the Revenue Act of 1943, sec. 158 of the Revenue Act of 1942; and sec. 216 of the Revenue Act of 1939.
[34] Sec. 158 (f) of the Revenue Act of 1942.
[35] Regulations 118, sec. 39.131 (h)-1 (b); Regulations sec. 1.903-1 (a). In general, these regulations provide that this provision is applicable only if the foreign country has a general income tax which is not imposed upon the taxpayer who is subjected to the substituted tax.
[36] S. Rept. No. 1622, 83d Cong., 2d sess., p. 106.

corporations; and a revision of the foreign tax credit provision to provide that a taxpayer who chooses to take the foreign tax credit must elect either to compute the credit by reference only to income taxes paid a foreign country, or, alternatively, by reference only to a "principal tax" imposed by a foreign country. These changes would have constituted a substantial revision of the existing tax treatment of foreign income. The Senate amendments to H. R. 8300 deleted these provisions and the House receded. The report of the committee of conference stated that action on these proposals should be "* * * postponed for a more thorough study." [37]

C. JUDICIAL INTERPRETATION

A foreign tax credit is allowed for "the amount of any income * * * taxes paid or accrued * * * to any foreign country." The meaning of the term "income taxes" is determined by reference to the meaning of that term "as used in our own revenue laws" regardless of what they may be called in the foreign country.[38] In making this determination, however, it is established that it is not necessary that the foreign tax be levied or computed on precisely the same basis as the United States income tax.[39] Thus, the foreign tax credit has been allowed for a Cuban tax of 3 percent of gross income imposed on navigation companies with respect to traffic beginning in Cuba,[40] a tax imposed by the municipality and Province of Habana, Cuba, solely upon net profits from the operation of gasworks and electric light plants,[41] and taxes paid to Mexico based on gross revenue from mining properties.[42] However, where the foreign levy constitutes in essence an excise tax, such as a privilege tax, it has been held that the levy cannot be characterized as an "income tax" for purposes of obtaining the foreign tax credit. Thus, the foreign tax credit has been denied in the case of metal production taxes imposed by the Mexican mining laws on the value of the mineral extracted where the tax attached even if the miner made no profits and even if he made no sales of the ore.[43] Similarly, the credit was denied in the case of a tax paid to the Province of Quebec under the Quebec Mining Act on the "annual profits" of mining companies where, under the prescribed method of determining the "annual profits," the tax was payable whether or not there was realization of gain or derivation of profit.[44]

The judicial decisions referred to above establish the general proposition that foreign taxes may qualify for the foreign tax credit where they are based upon the realized proceeds of business operations, whether the base is gross or net income. Where, on the other hand, they are in substance an excise tax, such as a tax on the privilege of doing business, they may not qualify for the foreign tax credit as an "income tax."

As discussed at the beginning of this report, the issue presented by the Aramco case is whether or not the levies imposed under the decree of November 1950, and under the decree of December 1950, are in

[37] H. Rept. No. 2543, 83d Cong., 2d sess., p. 68.
[38] *Biddle* v. *Commissioner*, 302 U. S. 573, 579 (1938).
[39] *Santa Eulalia Mining Company*, 2 T. C. 241 (1943), petition to review dismissed on stipulation, 142 F. 2d 450 (1944).
[40] *Seatrain Lines, Inc.*, 46 BTA 1076 (1942).
[41] *Havana Electric Railway Light and Power Co.*, 34 BTA 782 (1936).
[42] *Santa Eulalia Mining Company*, supra.
[43] *Commissioner* v. *American Metal Company, Limited*, 221 F. 2d 134 (2d Cir., 1955), cert. den. 350 U. S. 829 (1955).
[44] *Keasbey & Mattison Co.* v. *Rothensies*, 133 F. 2d 894 (3d Cir., 1943).

fact, as well as in name, income taxes eligible for the foreign tax credit. The statement of facts points out that the November 1950 decree has wide application to firms other than those developing mineral properties and that it is imposed on the net profits of companies (determined by allowing a deduction for business expenses, but not including any allowance corresponding to percentage depletion). Although in some details the base and computation of the tax differ from the method of determining the United States income tax, it is clear from the judicial decisions referred to above that this tax is eligible for the foreign tax credit. The remaining question, therefore, relates to the levy imposed by the December 1950 decree.[45]

With respect to the levy imposed by the December 1950 decree, the case of *New York & Honduras Rosario Mining Co.* v. *Commissioner*[46] closely parallels the facts of the Aramco case. In the Honduras case the taxpayer, a domestic corporation, had been engaged in mining in Honduras since 1880. A comprehensive mining code was promulgated in 1937, declaring Honduras to be the owner of all minerals and granting private parties the right to operate mines and dispose of the ore under regulations and conditions prescribed by the code. The mining code imposed an annual acreage tax and, in addition, imposed a tax on "liquid profits" of mining enterprises. In 1939 this additional tax was amended to read as follows:

> The mining enterprises shall pay to the State at least five percent of the liquid profits of the exploitation, said percentage to be fixed by contract with the executive power with special approval of the National Congress.

On January 18, 1940, the taxpayer and the Republic of Honduras entered into a contract for the taxpayer's exploitation of particularly described mines for a 20-year period. This contract, approved by legislative enactment of the National Congress, required the taxpayer to advance $250,000 (without interest) to the Honduran Government on account of the tax, and set the tax rate at 7 percent of the liquid profits from the exploitation of existing mines (5 percent in the case of new mines).[47]

The Commissioner contended that this was merely an excise tax imposed upon the privilege of doing business. The Tax Court agreed, holding that the amounts paid "were payments for the right and privilege of exploiting and operating particular properties and were not income taxes within the purview of section 131 * * *."[48] The Tax Court recited a number of circumstances in support of its decision: (1) Honduras had no general income tax law; (2) the payments in question were made pursuant to a provision in its mining code; (3) the payments were specifically determined and agreed upon in a contract between the Honduran Government and the taxpayer, under which contract the taxpayer acquired the right or privilege to exploit and operate the mines.

The Court of Appeals for the Second Circuit reversed the Tax Court, holding that the payments were "income taxes" entitling the taxpayer to the foreign tax credit. The court relied upon the follow-

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[45] As pointed out in the statement of facts, in 1956 the rate of the November tax was modified so that for future years the tax paid under the November decree will exceed the United States tax and the question of a credit for the December tax for the future will be moot.

[46] 168 F. 2d 745 (2d Cir., 1948), reversing 8 T. C. 1232 (1947).

[48] Computation of liquid profits was substantially the same as the computation of taxable income under United States law. Moreover, it was provided that in the case of dispute, the Honduran Government would use whatever sum the United States taxed as liquid profits.

[48] 8 T. C. at 1239.

ing facts in reaching its decision: (1) other provisions of the mining code lay genuine excise taxes with forfeiture of mining rights for nonpayment; (2) failure to pay the amounts in question did not involve forfeiture; (3) the tax was applicable to all miners and in general characteristics was the same as the United States income tax;[49] and (4) the tax was called an income tax.

With respect to the fact that the amount paid to the Honduras Government was fixed by contract, and that $250,000 was paid as an advance, the circuit court said:

> It must be conceded that the Honduran tax differs from our Federal income tax in permitting the rate of the tax if more than 5 percent of liquid profits was to be collected, to be determined by contract approved by the National Congress. But we do not see that this changes the character of the tax. If the minimum 5 percent rate is an income tax, as we think it is for reasons already stated, the additional 2 percent arranged by contract can have no different character. Nor do we think it material that $250,000 was paid down as an advance against which the annual taxes were to be charged off. It is true that if the taxpayer stopped operations, Honduras was not obligated to repay any portion of the advance; but the taxpayer has not stopped operations. In the years 1941 and 1942 the sum advanced stood as a credit to the taxpayer; we are concerned with the debits charged against it in those years. Those debits we hold were payments of income taxes to a foreign country. To hold otherwise would defeat the purpose of section 131, which was to encourage domestic corporations to do business abroad without having to operate through a foreign corporation, the inducement being that their income from operations abroad should be taxed only once.

Upon the basis of these judicial decisions, it appears that the decision to allow a tax credit to Aramco with respect to amounts paid under the December 1950 decree was proper. The tax was levied on net income arising from business operations; it is not imposed by the franchise agreement (nor do the enforcement provisions of the tax require forfeiture on nonpayment); there is a separate royalty provided in the franchise (failure to pay which would abrogate the franchise); and it is designated by the sovereign as an income tax.

D. INTERNAL REVENUE SERVICE POLICY

A number of cases presented to the Internal Revenue Service have involved substantially the same issues as the Aramco case. The Service has followed a uniform policy of allowing a foreign tax credit in such cases. A denial of the foreign tax credit to Aramco would have constituted a departure from the Service's prior consistent policy and would have had the effect of according Aramco less favorable treatment than that accorded other taxpayers similarly situated

In the case of *United Fruit Company*, A–405437, settled by ruling, the taxpayer had a franchise from Honduras to operate a railroad and port. Originally, the taxpayer had an exemption from income taxes. To avoid the prospect of nationalization the taxpayer agreed to pay Honduras 15 percent of the net profits. The ruling held that this was a waiver of tax exemption and not a royalty and thus was eligible for the foreign tax credit.

In Rev. Rul. 55–454, C. B. 1955–2, 287, the Internal Revenue Service held that taxes on net profits paid to Costa Rica by a United

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[49] The court distinguished the Quebec mining tax held not to be an "income tax" in *Keasbey & Mattison Co.* v. *Rothensies, supra*, at footnote 44. It pointed out that the Quebec tax was not laid upon income as computed by United States standards, but rather upon the "gross value of the year's output" less the costs incurred in the mining operation. The Honduran tax, on the other hand, the court stated "* * * is not laid on the value of the minerals mined but on 'the amount received from its exports,' i. e., gross income, less operating expenses within Honduras and expenses abroad directly applicable to management of the mines, plus reasonable deductions for amortization and depletion." 168 F. 2d at 748.

States corporation are eligible for the foreign tax credit, notwithstanding the fact that the taxes are limited as to maximum rate by a contract between the particular taxpayer and the Costa Rican Government, which contract is duly approved by the Costa Rican Legislative Assembly.

In I. T. 4038, 1950–2 C. B. 54, it was held that a 50-percent tax imposed by Venezuela on income from exploitation of mines or hydrocarbon deposits was an income tax and eligible for the foreign tax credit.

In a ruling letter to Standard Oil Company of New Jersey, dated July 12, 1954 (Iran income-tax law, amendment of, A–610204), the Internal Revenue Service ruled with respect to the application of the foreign tax credit to a tax proposed to be enacted by Iran applicable to the income of companies domiciled in a foreign country whose profits are derived from the sale of oil produced or exported from Iran. (Under the proposed law foreign companies would be required to pay a flat rate of 50 percent, but companies deriving their income from oil would be entitled to credit against their tax the amount of any royalties paid to the Iranian Government.) The ruling held that if the proposed law were enacted taxes paid by such companies to Iran would be eligible for the foreign tax credit if a royalty of approximately 12½ percent of gross profits was required to be paid by the companies. The proposed law was enacted and a favorable ruling was granted on September 7, 1954 (A–613339). This ruling is closely related to the ruling involved in the Aramco case. In this connection it should be pointed out that in the Aramco case also a separate royalty is required to be paid. This royalty is expressed in terms of dollars per ton of crude oil. The Aramco royalty rate varies with both the content of refined oil in a given output of crude and with the price of refined oil. It is understood that the royalty has averaged about 11 percent of gross profits.[50] This appears to be generally in line with royalty rates in other nearby areas, such as 10 percent in India, and 12½ percent in Basra, Mosul, and Turkey.[51]

Part IV. Summary and Conclusions

A. THE FACTS

1. Aramco is a United States corporation subject to United States taxes and, with the usual limitations, is eligible for a tax credit for income taxes paid foreign governments on foreign earnings.

2. In 1933, Aramco (then known as the California-Arabian Standard Oil Co.) entered into an agreement with Saudi Arabia under which oil rights in large areas of the country were conveyed to the company for a 60-year period. The company agreed to a royalty payment of 4 shillings gold per ton plus certain advance payments and Saudi Arabia (among other things) agreed that the company would be exempt from all direct and indirect taxes. Currently, this royalty payment amounts to about 11 percent of gross profits. In 1939 a new agreement extended the concession areas and continued the agreement for 60 years from 1939.

[50] Letter dated January 6, 1955, from Acting Chief Counsel, Internal Revenue Service, to Assistant Commissioner (Technical). (Shown in appendix No. 5.)
[51] Ibid.

3. In November of 1950, Saudi Arabia imposed what purported to be a general flat rate 20 percent income tax on business net profits, in general allowing deductions for business expenses but not for percentage depletion.

4. In December of 1950, what purported to be a tax of 50 percent was imposed on the net income of companies producing petroleum and hydrocarbon products. This tax also allowed no deduction for percentage depletion. However, in addition it allowed no deductions for royalty payments, taxes, or other payments to Saudi Arabia. Instead, the royalty, tax and other payments to Saudi Arabia were allowed as a credit against this levy. This arrangement assured Saudi Arabia a 50-percent share of an oil company's profits.

5. Also in December of 1950, Aramco's prior agreement with Saudi Arabia was modified to remove the company's tax exemption and to substitute a commitment that royalties, taxes and other payments by Aramco to Saudi Arabia were not to exceed 50 percent of its gross income less, in general, operating costs (not including depletion), losses, depreciation and income taxes payable to foreign countries (such as the United States) but not reduced by amounts paid to the Saudi Arabian Government.

6. Since 1950 the application of the November 1950 tax has been restricted to foreign businesses, at least partially because Saudi nationals are subject to certain religious taxes. In addition, graduated rates have been substituted for the prior flat rate. The new rates begin at 20 percent and increase to a maximum of 40 percent on large incomes. Since no percentage depletion deduction is allowed in computing this tax, in terms of United States income concepts this top rate is the equivalent of a tax at a rate slightly over the 52 percent United States rate. As a result, since 1956 only the November 1950 levy, as amended, is applicable in the case of Aramco.

7. The Internal Revenue Service ruled that both the November and the December 1950 taxes are income taxes and, therefore, can be credited against income taxes Aramco would otherwise have to pay to the United States. This has resulted in credits increasing from $46 million in 1950 to almost $177 million in 1955. In 1950, 1951, and 1952 the net tax paid by Aramco to the United States amounted to less than $1 million. In each of the years since that time the credit has completely offset the United States tax.

B. THE ISSUE

The issue is whether the amounts paid Saudi Arabia under the November and December 1950 decrees are properly classified as income taxes, as the Internal Revenue Service has ruled, or whether they are more properly classified as some other type of payment (such as a royalty payment, as some have contended). If these amounts are properly classified as income taxes, they are, of course, proper credits against the tax Aramco would otherwise be required to pay to the United States, thereby either substantially reducing or eliminating any payment of United States tax.

C. CONCLUSIONS AS TO SERVICE RULING

On the basis of the statutory provisions, their legislative history, and the judicial decisions, the joint committee staff has concluded

that the ruling issued to Aramco by the Internal Revenue Service represented a proper interpretation of the law. Moreover, this ruling appears to be consistent with the decisions made by the Internal Revenue Service with respect to other similarly situated taxpayers. The basis for the above statements can be summarized as follows:

1. The legislative history of the statutory provisions indicates that the foreign tax credit has been frequently reexamined over an extended period of time and has indicated that its dual intent was to prevent double taxation and to encourage foreign trade or investment.

2. Judicial decisions have clearly established that a foreign tax credit is allowable with respect to taxes generally imposed on a class of taxpayers and based on realized proceeds of business operations whether the base for the tax is gross or net income. The November 1950 levy of Saudi Arabia clearly qualifies for the foreign tax credit on this basis. It is imposed on a substantial number of enterprises and has as a base what in the United States approximates taxable income (with the exception that it makes no allowance for a depletion deduction).

3. Similarly, the judicial decisions support the allowance of the foreign tax credit with respect to amounts paid pursuant to the December 1950 decree. The decision by the Court of Appeals for the Second Circuit in the New York and Honduras Rosario Mining Co. case appears to establish the fact that a credit is properly allowable with respect to the December 1950 levy by Saudi Arabia. In both cases:

(*a*) The foreign governments involved were the owners of all mineral rights and had the right to establish the conditions under which the minerals could be extracted.

(*b*) The specific taxes were imposed only upon the particular taxpayers. In the Honduras case a minimum tax of 5 percent was imposed by the mining laws on the "liquid profits" of mining enterprises. By a contract applying only to the particular taxpayer, however, this tax was increased to 7 percent of the taxpayer's profits from existing mines. The December 1950 decree by Saudi Arabia on petroleum and hydrocarbon companies was applicable to all such companies. However, it appears that Aramco was the only company engaged in that type of business in Saudi Arabia at the time of the ruling (although at least one other concession had been granted by Saudi Arabia at that time). The December 1950 levy in the Saudi Arabia case was not, however, established by contract with Aramco.

4. In the several cases presented to the Internal Revenue Service involving substantially the same issues as in the Aramco case, the Service has consistenly allowed credits for the foreign taxes. To do otherwise in the Aramco case would be to treat Aramco less favorably than other taxpayers.

D. AREAS FOR LEGISLATIVE CONSIDERATION SUGGESTED BY THE ARAMCO RULING

Although it is believed that the Service ruling with respect to Aramco represents a proper interpretation of existing law, it nevertheless is not clear that the result is altogether satisfactory from the standpoint of legislative tax policy. In the case of extractive indus-

tries generally, where the foreign government imposing an income tax is also the same entity to whom fees are paid for the privilege of extraction, it may well be immaterial to the foreign government as to how the total amount paid by an industry is divided between the tax and the extraction fees. Because of the manner in which the United States foreign tax credit works, the division of these payments between income taxes and extraction fees, however, is of considerable consequence to the industry involved. The foreign income taxes, to the extent of United States taxes on the same income, can be offset dollar for dollar against the United States taxes. The extraction fees, however, are only deductible in computing the United States taxes, and thus decrease United States taxes only to the extent of 52 percent or to the extent of the applicable marginal tax rate. Therefore, in their dealings with the foreign government such industries, naturally, can be expected to favor the imposition of foreign income taxes rather than comparable extraction fees or royalties.

Within the framework of the present foreign tax credit it would appear that this problem of the interrelationship of taxes and extraction fees might be met by limiting the foreign taxes which can be credited to those which are generally imposed by the foreign country to both its nationals and nationals of other countries and only then to the extent the specific tax rates in question also are generally applicable. Perhaps such a limitation would need to be applied only where the industries involved are extractive industries and the right to impose charges for the privilege of extraction is in the hands of the taxing authority.

In a broader sense the Aramco problem is only one instance of what may well be an inherent difficulty with the foreign tax credit. On one hand American corporations operating in foreign countries have no incentive to discourage heavier income taxation by the foreign country in which they operate (if this rate is no higher than the United States tax rate) because, to the extent they do not pay to the foreign government the equivalent of the United States tax on the foreign income, they must pay this amount to the United States Government. Moreover, the foreign government in such cases may well conclude that if a United States company doing business there is to pay a 52-percent tax in any case, there is no reason why it should not receive the total tax payment. On the other hand, countries desiring to attract investments by American companies by either general or special tax reductions find their efforts frustrated (where the foreign tax rate does not exceed the United States tax rate) by the fact that as their income tax rate is lowered the American tax because of the method of operation of the foreign tax credit, is increased.

Various alternatives have been suggested as ways of dealing with this problem of the effect of the foreign tax credit on foreign tax rate structures. Alternatives which would appear to merit consideration are as follows:

1. One possibility is to impose the applicable United States tax on only a specific percentage (perhaps something like 75 percent) of the foreign income received by American corporations, and, regardless of the foreign tax imposed, allow no foreign tax credit as an offset to this tax. The foreign taxes could, however, be deductible in computing the United States tax. Such tax treatment for American

corporate income earned abroad would remove any inducement in the present system to raise, or maintain, high foreign income-tax rates. On the other hand, it would also mean that some American income earned abroad would pay aggregate taxes above the generally applicable rates in either the United States or the foreign country, while other such income would be taxed at a rate below the generally applicable United States rate.

2. Another possibility is to provide a special low-rate American tax applicable to foreign income, in lieu of the regular corporate income tax rates. Under this alternative foreign taxes would be deductible in computing this special low-rate American tax but no credit would be allowed for these foreign taxes. Like the first alternative, this would eliminate any inducement, arising from the foreign tax credit, for a foreign country to raise, or maintain, high income tax rates. However, also like the first alternative, it would mean that the aggregate American and foreign income taxes payable with respect to such foreign income would in some cases be more than either the United States or foreign tax rates and in other cases would be less than the United States tax rate.

3. Another alternative is to retain the present foreign tax credit provision but to limit the credit to some specific percentage on the net foreign income. This is somewhat similar to the requirement in present law that percentage depletion cannot exceed 50 percent of the taxable income from the property. A proposal of this general type was in fact made in the House version of the Revenue Act of 1934 which in effect would have limited the tax credit to 50 percent of what the United States tax would be on the foreign income. Thus, it would, for example, be possible to limit the credit taken on foreign taxes to something like 75 percent of what the United States tax would be on this foreign income. The effect of such a limitation would be to remove any inducement to raise or maintain any foreign income tax rates at any level more than, say, three-quarters that of the United States tax rates. As under the first possibility listed above, this alternative would mean that some American income earned abroad would pay aggregate taxes above the generally applicable rates in either the United States or the foreign country, although there would be fewer cases of this type than under the first alternative. Moreover, there would be no cases where the aggregate tax burden was below the tax generally imposed by either the United States or the foreign country.

4. It should be recognized that the alternative discussed in No. 3 above in some cases would increase tax burdens on American income earned abroad, but in no case would reduce tax burdens. In view of this, a variant of this alternative appears to be worth consideration. Such a variant could provide a limitation on the foreign tax credit of the type described in alternative No. 3 (such as limiting the credit to 75 percent) but combine it with a modest reduction in the United States tax rate for this type of income. For example, it could provide a United States rate of perhaps 40 percent in place of 52 percent for such income. Such a variant would remove any inducement to raise, or maintain, a foreign tax rate at any level above 30 percent. Also, it would make it less likely that the combined foreign and American taxes would exceed the taxes which are generally imposed by the United States.

5. A fifth alternative is for the United States to establish its tax treatment of foreign income on a country-by-country basis through the negotiation of tax treaties with interested countries. Thus, it would be possible to repeal the foreign tax credit effective as of some future date, perhaps 2 or 3 years away. Then, unless a tax treaty were entered into with a country, foreign taxes could only be deducted in computing American income, and not credited against the United States tax. The policy to be followed in entering into tax treaties in this case could be to grant concessions in American taxes on foreign income no greater than the benefit which presently could be obtained from the foreign tax credit, such concessions being granted, however, only in exchange for concessions by the foreign country in its rates applicable to American businesses located there. This should provide an important bargaining point which the United States could use in inducing foreign countries actively interested in American investments to lower their tax rates on the income from such investment. On the other hand, income derived by American companies from countries not so interested would, under this alternative, pay aggregate taxes above the generally applicable rates in either the United States or the foreign country.

6. A sixth alternative is to provide the same tax treatment for United States domestic corporations as is presently available to foreign subsidiaries of United States corporations as to the timing of the imposition of the American tax. Thus, the foreign earnings of a United States corporation under this alternative would not be taxed until they were brought back to the United States for use in a trade or business in the United States or for distribution to stockholders. To the extent an American firm intended to use its foreign earnings in foreign investments, either in the same country where the earnings were derived, or in another, this alternative would remove any effect the foreign tax credit presently has to induce a foreign country to raise its rates to, or maintain its rates at, the level of the United States rates. The inducement to raise or maintain high rates in a foreign country would still remain only to the extent a firm brings its earnings back to the United States for use in a trade or business here or for distribution to stockholders. If this alternative were followed it would be necessary to distinguish carefully between funds brought back to the United States on a temporary basis but which are not used in a trade or business here. As in the case of funds similarly held here by a foreign subsidiary, such funds under this alternative would not at that time become subject to United States taxes.

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APPENDIXES

Appendix 1. Revenue Ruling 55–296

INTERNAL REVENUE BULLETIN

May 16, 1955
No. 20

SECTION 131 (A).—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES: ALLOWANCE OF CREDIT

Regulations 118, Section 39.131 (a)–1: Analysis of credit for taxes. Rev. Rul. 55–296

The Government of Saudi Arabia by Royal Decree No. 17/2/28/3321, dated November 4, 1950, imposed a general income tax on incomes of individuals and corporations and applies to all persons except those specifically exempted. By Royal Decree No. 17/2/28/7634, dated December 27, 1950, the Government of Saudi Arabia imposed an additional tax on every company registered or required to be registered in accordance with the Decree for the Reigstration of Companies and engaged in the production of petroleum or other hydrocarbons in the Kingdom of Saudi Arabia. Held, both the general income tax and the additional tax imposed under the foregoing Decrees come within the United States concept of an income tax and are allowable as a credit against United States income tax under the provisions of section 131 (a) of the Internal Revenue Code of 1939, subject to the limitations of section 131 (b) of the Code.

PART I.—ORIGINAL CONCESSION AGREEMENT

Between Saudi Arab Government and Standard Oil Company of California.

Execution.

Signed at Jeddah, May 29, 1933.

Ratifications.

Ratified by Standard Oil Company of California July 5, 1933, pursuant to a Resolution of the Board of Directors at a regular meeting held on the same date.

Ratified by His Majesty Abdul Aziz Bin Abdul Rahman Al Faisal Al Saud, King of Saudi Arabia, by Decree No. 1135 dated July 7, 1933.

Effective Date.

Became effective by publication in the Om-ul Qura, official Government journal, July 14, 1933.

Assignment.

Assigned by Standard Oil Company of California to California Arabian Standard Oil Company, a Delaware corporation, December 29, 1933.

Amendments.

Articles 9 and 19 were amended respectively by Articles 7 and 8 of the Supplemental Agreement of May 31, 1939.

The latter Agreement also superseded the provisions of Article 3 insofar as said provisions relate to the Saudi Arab-Kuwait Neutral Zone.

Change in Company Name.

The name of the Company was changed from **California Arabian Standard Oil Company** to **Arabian American Oil Company** on January 31, 1944.

Extensions.

The term of the Agreement, as defined in Article 1, and the term of Article 9 as amended by Article 7 of the Supplemental Agreement, were extended for a period of two years by exchange of letters from the Minister of Finance to F. A. Davies dated January 18, 1941, and from F. A. Davies to the Minister of Finance dated January 19, 1941.

The above terms were extended for an additional period of two years by an exchange of letters from the Company to the Minister of Finance dated April 24, 1943 and from the Minister of Finance to the Company dated June 15, 1943.

THIS AGREEMENT made between His Excellency, Shaikh Abdulla Suleiman Al Hamdan, Minister of Finance of Saudi Arabia, acting on behalf of the Saudi Arab Government (hereinafter referred to as the "Government") of the one part, and L. N. Hamilton, acting on behalf of Standard Oil Company of California (hereinafter referred to as the "Company") of the other part.

It is hereby agreed between the Government and the Company in manner following:—

ARTICLE 1.

The Government hereby grants to the Company on the terms and conditions hereinafter mentioned, and with respect to the area defined below, the exclusive right, for a period of sixty years from the effective date hereof, to explore, prospect, drill for, extract, treat, manufacture, transport, deal with, carry away and export petroleum, asphalt, naphtha, natural greases, ozokerite, and other hydrocarbons, and the derivatives of all such products. It is understood, however, that such right does not include the exclusive right to sell crude or refined products within the area described below or within Saudi Arabia.

ARTICLE 2.

The area covered by the exclusive right referred to in Article 1 hereof is all of eastern Saudi Arabia, from its eastern boundary (including islands and territorial waters) westward to the westerly edge of the Dahana, and from the northern boundary to the southern boundary of Saudi Arabia, provided that from the northern end of the westerly edge of the Dahana the westerly boundary of the area in question shall continue in a straight line north thirty degrees west to the northern boundary of Saudi Arabia, and from the southern end of the westerly edge of the Dahana such boundary shall continue in a straight line south thirty degrees east to the southern boundary of Saudi Arabia.

For convenience this area may be referred to as the "exclusive area".

ARTICLE 3.

In addition to the grant of the exclusive area described in Article 2 of this agreement, the Government also hereby grants to the Company a preference right to acquire an oil concession covering the

balance of eastern Saudi Arabia extending as far west of the westerly boundary of the exclusive area as the contact between the sedimentary and igneous formations. This preference right includes such rights as the Government may now have, or may hereafter acquire, in the so-called Neutral Zone bordering on the Persian Gulf to the south of Kuwait. The nature of this preference right is to be hereafter agreed upon. The term "oil concession" as used in this Article means an exclusive concession covering the same products which are covered by the present agreement.

Furthermore, the Company's geologists shall have the right to examine the region covered by the preference right just referred to (excepting the Neutral Zone referred to above), in so far as such examination may be necessary or advisable for a better understanding of the geological character of the exclusive area.

Article 4.

Within the time agreed in Article 18 of this agreement, the Company shall make an initial loan to the Government of thirty thousand pounds, gold, or its equivalent.

Article 5.

The Company shall pay the Government annually the sum of five thousand pounds, gold, or its equivalent. For convenience this payment is termed an annual rental and it is payable in advance. The first annual rental shall be paid within the time agreed in Article 18 of this agreement; thereafter, so long as the contract is not terminated, the annual rental shall be due upon each anniversary of the effective date hereof and shall be payable within thirty days after such anniversary, provided that upon the commercial discovery of oil no further annual rentals shall be due or payable.

Article 6.

If this contract has not been terminated within eighteen months from the effective date hereof, the Company shall make a second loan to the Government, amounting to twenty thousand pounds, gold, or its equivalent. The due date of such loan shall be eighteen months from the effective date hereof but the Company shall have fifteen days from the due date within which to make the loan.

Article 7.

During the life of this agreement, the Government shall be under no obligation to repay the initial loan of £30,000, gold, (or its equivalent), or the second loan of £20,000, gold, (or its equivalent). The Company shall have the right to recover the amount of these two loans by way of deductions from one-half of the royalties due the Government. If the amount of the two loans, in whole or in part, shall not have been so recovered by the Company upon the termination of this contract, the Government shall repay the unrecovered amount in four equal and consecutive annual instalments, the first instalment to be paid within one year from the date of the termination of this agreement. Furthermore until such unrecovered amount has been repaid by the Government, the Company's preference right referred to in Article 3 hereof, shall continue in force.

Article 8.

Upon the effective date of this agreement, the Company shall commence plans and preparations for geological work, so planning the work as to take advantage of the cooler season for more efficient work in the field, and of the hotter season for the necessary office work of compiling data and reports. In any event, the actual field work shall commence not later than the end of September, 1933, and it shall be continued diligently until operations connected with drilling are commenced, or until the contract is terminated.

Article 9.

[*Amended by Article 7 of Supplemental Agreement*]

Within ninety days after the commencement of drilling, the Company shall relinquish to the Government such portions of the exclusive area as the Company at that time may decide not to explore further, or to use otherwise in connection with this enterprise. Similarly, from time to time during the life of this contract, the Company shall relinquish to the Government such further portions of the exclusive area as the Company may then decide not to explore or prospect further, or to use otherwise in connection with the enterprise. The portions so relinquished shall thereupon be released from the terms and conditions of this contract, excepting only that during the life of this contract the Company shall continue to enjoy the right to use the portions so relinquished for transportation and communication facilities, which however shall interfere as little as practicable with any other use to which the relinquished portions may be put.

ARTICLE 10.

The Company shall commence operations connected with drilling as soon as a suitable structure has been found, and in any event if the Company does not commence such operations within three years from the end of September, 1933 (subject to the provisions of Article 27 hereof), the Government may terminate this contract. Once commenced, these operations shall be continued diligently until oil in commercial quantities has been discovered, or until this agreement is terminated. If the Company should fail to declare so sooner, the date of discovery of oil in commercial quantities shall be the date upon which the Company has completed and tested a well or wells capable of producing, in accordance with first-class oilfield practice, at least two thousand tons of oil per day for a period of thirty consecutive days.

Operations connected with drilling include the ordering and shipping of materials and equipment to Saudi Arabia, the construction of roads, camps, buildings, structures, communication facilities, etc., and the instalation and operation of the machinery, equipment and facilities for drilling wells.

ARTICLE 11.

Upon the discovery of oil in commercial quantities, the Company shall advance to the Government the sum of fifty thousand pounds, gold, or its equivalent, and one year later the further sum of fifty thousand pounds, gold, or its equivalent. The due date of the first advance shall be the date of discovery of oil in commercial quantities, as provided in Article 10 hereof, and the due date of the second advance shall be one year later. In each case the Company shall have sixty days following the due date within which to make the advance. Both of these advances are on account of royalties which may be due the Government and consequently the Company shall have the right to recover the amount of these advances by way of deductions from one-half of the royalties due the Government.

ARTICLE 12.

Since it has been agreed that the annual rental of five thousand pounds, gold, or its equivalent, is payable to the date of the discovery of oil in commercial quantities, and since it has been agreed also that this annual rental is to be payable in advance, it may happen that the last annual rental paid prior to the date of discovery of oil in commercial quantities will cover a period beyond the date of such dis-

covery. In case that this period should be equal to or greater than one-fifth of a year, the proportionate amount of the five thousand pounds, gold, or its equivalent, corresponding to such period shall be treated as an advance on account of royalties due the Government, and consequently it shall be recoverable by the Company by way of deductions from one-half of the royalties due the Government.

Article 13.

As soon as practicable (i.e., allowing a reasonable time for ordering and shipping further materials and equipment to Saudi Arabia and commencing further work) after the date of discovery of oil in commercial quantities, the Company shall continue operations connected with drilling by using at least two strings of tools. These operations shall be continued diligently until the proven area has been drilled up in accordance with first-class oilfield practice, or until the contract is terminated.

Article 14.

The Company shall pay the Government a royalty on all net crude oil produced and saved and run from field storage, after first deducting:

(1) water and foreign substances; and

(2) oil required for the customary operations of the Company's instalations within Saudi-Arabia; and

(3) the oil required for manufacturing the amounts of gasoline and kerosene to be provided free each year to the Government in accordance with Article 19 hereof.

The rate of royalty per ton of such net crude oil shall be either:

(a) four shillings, gold, or its equivalent; or

(b) at the election of the Company at the time of making each royalty payment, one dollar, United States currency, plus the amount, if any, by which the average rate of exchange of four shillings, gold, during the last half of the semester for which the royalty payment is due, may exceed one dollar and ten cents, United States currency. Thus, for example, if such average rate should be one dollar and fourteen cents, United States currency (that is to say, five dollars and seventy cents per gold pound), the royalty rate would be one dollar and four cents, United States currency, per ton of such net crude oil.

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ARTICLE 15.

If the Company should produce, save and sell any natural gas, it will pay to the Government a royalty equal to one-eighth of the proceeds of the sale of such natural gas, it being understood however that the Company shall be under no obligation to produce, save, sell, or otherwise dispose of any natural gas. It is also understood that the Company is under no obligation to pay any royalty on such natural gas as it may use for the customary operations of its instalations within Saudi Arabia.

ARTICLE 16.

The Government, through duly authorized representatives, may, during the usual hours of operations, inspect and examine the operations of the Company under this contract and may verify the amount of production. The Company shall measure in accordance with first-class oilfield practice the amount of oil produced and saved and run from field storage, and shall keep true and correct accounts thereof, and of any natural gas it may produce and save and sell, and duly authorized representatives of the Government shall also have access at all reasonable times to such accounts. The Company shall, within three months after the end of each semester, commencing with the date of commercial discovery of oil, deliver to the Government an abstract of such accounts for the semester, and a statement of the amount of royalties due the Government for the semester. These accounts and statements shall be treated as confidential by the Government, with the exception of such items therein as the Government may be required to publish for fiscal purposes.

The royalties due the Government at the end of each semester, commencing with the date of commercial discovery of oil, shall be paid within three months after the end of the semester. In case of any question as to the amount of royalties due for any semester, such portion of the amount as may be unquestioned shall be tendered the Government within the period hereinabove provided, and thereupon the question shall be settled by agreement between the parties, or failing that, by arbitration as provided in this contract. Any further sum which may be payable to the Government as a result of this settlement shall be paid within sixty days after the date of such settlement.

ARTICLE 17.

It is agreed that all gold payments provided in this contract, whether pounds gold or shillings gold, are to be based on the gold pound standard according to its weight and fineness at the time the

payments may be due. It is also agreed that wherever it is stipulated in this contract that the equivalent of any sum or amount in pounds gold or in shillings gold may be paid, such equivalent may be dollars in United States currency, or pounds sterling.

It is agreed furthermore that the equivalent of pounds gold or shillings gold, for any payment which may be made hereunder in dollars, United States currency, or in pounds sterling (with the exception of the first payment provided for in Article 18 hereof) shall be based on the average of the rate of exchange as computed over a period of three months immediately preceding the due date of the payment.

Article 18.

All payments provided in this contract to be made to the Government may be made by tendering such payments directly to the Government, or by depositing the amount due to the credit of the Government in some bank which the Government designates in writing and which the Government may change from time to time by giving written notice to the Company long enough in advance so that the Company will have sufficient time to make future payments to the new bank. It is agreed that the Government will designate such bank in Saudi Arabia, or in the United States of America, or in England, or in Holland, but that no bank in Saudi Arabia will be so designated unless such bank has a correspondent in United States of America, England or Holland through which bank transfers of money to Saudi Arabia may be made. Once the Company has made the proper payment to the Government, or has deposited the proper sum in any such bank, or has paid the sum to such correspondent for transfer to a bank in Saudi Arabia, the Company shall be free of all further responsibility in connection with the payment.

It is agreed, however, that the first payment of thirty-five thousand pounds, gold, or its equivalent (comprising the initial loan and the first annual rental) shall be made, within fifteen days after the effective date of this agreement, to a correspondent, in New York or in London, of Netherlands Trading Society (Nederlandsche Handel-Maatschappij) at Jedda, Saudi Arabia, to be transmitted without delay, and at the expense of the Company, to said Society and to be delivered to the Government upon obtaining a proper receipt from the Government for such payment. If this first payment is not made in gold, it will be made in pounds sterling at the current rate of exchange at the time the Company makes the payment to such correspondent.

Article 19.

[*Amended by Article 8 of Supplemental Agreement*]

As soon as practicable after the date of discovery of oil in commercial quantities, the Company shall select some point within Saudi Arabia for the erection of a plant for manufacturing sufficient gasoline and kerosene to meet the ordinary requirements of the Government, providing of course that the character of the crude oil found will permit of the manufacture of such products on a commercial basis by the use of ordinary refining methods, and provided further that the amount of oil developed is sufficient for the purpose. It is understood that the ordinary requirements of the Government shall not include resale inside or outside of the country. Upon the completion of the necessary preliminary arrangements, and as soon as the Company has obtained the Government's consent to the proposed location, the Company shall proceed with the erection of such plant. During each year following the date of completion of this plant, the Company shall offer free to the Government, in bulk, two hundred thousand American gallons of gasoline and one hundred thousand American gallons of kerosene, it being understood that the facilities provided by the Government for accepting these deliveries shall not impede or endanger the Company's operations.

Article 20.

The Company, at its own expense, will employ the necessary number of guards and guides to protect its representatives, its camps and instalations. The Government promises to cooperate fully in supplying the best soldiers and men available for this responsibility, and in furnishing every reasonable protection, at rates not exceeding those customarily paid by the Government or others for similar services, it being understood that the expense for such services shall be paid by the Company through the Government.

Article 21.

In return for the obligations assumed by the Company under this contract, and for the payments required from the Company hereunder, the Company and enterprise shall be exempt from all direct and indirect taxes, imposts, charges, fees and duties (including, of course, import and export duties), it being understood that this privilege shall not extend to the sale of products within the country, nor shall it extend to the personal requirements of the individual employees of the Company. Any materials imported free of duty may not be sold within the country without first paying the corresponding import duty.

Article 22.

It is understood, of course, that the Company has the right to use all means and facilities it may deem necessary or advisable in order to exercise the rights granted under this contract, so as to carry out the purposes of this enterprise, including, among other things, the right to construct and use roads, camps, buildings, structures and all systems of communication; to instal and operate machinery, equipment and facilities in connection with the drilling of wells, or in connection with the transportation, storage, treatment, manufacture, dealing with, or exportation of petroleum or its derivatives, or in connection with the camps, buildings and quarters of the personnel of the Company; to construct and use storage reservoirs, tanks and receptacles; to construct and operate wharves, piers, sea-loading lines and all other terminal and port facilities; and to use all forms of transportation of personnel or equipment, and of petroleum and its deratives. It is understood, however, that the use of aeroplanes within the country shall be the subject of a separate agreement.

The Company shall also have the right to develop, carry away and use water. It likewise shall have the right to carry away and use any water belonging to the Government, for the operations of the enterprise, but so as not to prejudice irrigation or to deprive any lands, houses, or watering places for cattle, of a reasonable supply of water from time to time.

The Company may also take and use, but only to the extent necessary for the purposes of the enterprise, other natural products belonging to the Government, such as surface soil, timber, stone, lime, gypsum, stone and similar substances.

Government officials and agents, in pursuance of official business, shall have the right to use such communication and transportation facilities as the Company may establish, provided that such use shall not obstruct or interfere with the Company's operations hereunder and shall not impose upon the Company any substantial burden of expense.

In times of national emergency, the use of the Company's transportation and communication facilities by the Government shall entitle the Company to fair compensation for any loss it may sustain thereby, whether through damages to the Company's facilities, equipment or instalations or through the obstruction or interference with the Company's operations.

Article 23.

The enterprise under this contract shall be directed and supervised by Americans who shall employ Saudi Arab nationals as far as practicable, and in so far as the Company can find suitable Saudi Arab employees it will not employ other nationals.

In respect of the treatment of workers, the Company shall abide by the existing laws of the country applicable generally to workers of any other industrial enterprise.

Article 24.

The Government reserves the right to search for and obtain any substances or products, other than those exclusively granted by this contract, within the area covered by this agreement, except lands occupied by wells or other instalations of the Company, provided always that the right thus reserved by the Government shall be exercised so as not to endanger the operations of the Company or interfere with its rights hereunder, and provided also that a fair compensation shall be paid the Company by the Government for all damage the Company may sustain through the exercise of the right so reserved by the Government. In any grant of such right so reserved by the Government, the concessionaire shall be bound by the provisions of this Article.

Article 25.

The Company is hereby empowered by the Government to acquire from any occupant the surface rights of any land which the Company may find necessary to use in connection with the enterprise, provided that the Company shall pay the occupant for depriving him of the use of the land. The payment shall be a fair one with respect to the customary use made of the land by the occupant. The Government will lend every reasonable assistance to the Company in case of any difficulties with respect to acquiring the rights of a surface occupant.

The Company, of course, shall have no right to acquire or to occupy Holy Places.

Article 26.

The Company shall supply the Government with copies of all topographical maps and geological reports (as finally made and approved by the Company) relating to the exploration and exploitation of the area covered by this contract. The Company shall also furnish the Government, within four months after the end of each year, com-

mencing with the date of commercial discovery of oil, a report of the operations under this contract during the year. These maps and reports shall be treated as confidential by the Government.

ARTICLE 27.

No failure or omission on the part of the Company to carry out or to perform any of the terms or conditions of this contract shall give the Government any claim against the Company, or be deemed a breach of this contract, in so far as such failure or omission may arise from force majeure. If through force majeure the fulfilment of any term or condition of this contract should be delayed, the period of the delay, together with such period as may be required for the restoration of any damage done during such delay, shall be added to the terms or periods fixed in this contract.

ARTICLE 28.

The Company may terminate this contract at any time by giving the Government thirty days' advance notice in writing, whether by letter or by telegraph, provided that the telegraphic notice is promptly confirmed by letter. Upon the termination of this contract through such notice, or through any other cause, the Government and the Company shall thereafter be free of all further obligations under this contract, except as follows:—

1. The Company's immovable property, such as roads, water or oil wells with their casings, permanent buildings and structures, etc., shall become the property of the Government free of charge.

2. The Company shall afford the Government an opportunity to purchase the movable property of the enterprise in Saudi Arabia at a fair price equal to the replacement value of such property at the time less depreciation. Any controversy about this fair price shall be settled by arbitration in the same manner as provided in Article 31 of this contract. If the Government declines or fails, within two months following the date of the termination of this contract, to purchase such movable property, or if the Government fails to tender the purchase price within thirty days after it has been decided upon, by agreement or by arbitration, the Company shall then have six months within which to remove such property.

3. If, in accordance with Article 7 of this contract, there is any unrecovered amount still due the Company, the provisions of Article 7 shall remain in force until the obligation therein mentioned has been satisfied.

Article 29.

In case of the breach by the Company of its obligation to make the second loan of twenty thousand pounds, gold, or its equivalent, as provided in Article 6 hereof, or of its obligation to commence operations connected with drilling as set forth in Article 10 hereof, or of its obligation to make the two advances each of fifty thousand pounds, gold, or the equivalent, under the terms and conditions provided in Article 11 hereof, or of its obligation under Article 30 hereof to pay the amount of any damages which may be assessed upon the Company, the Government's remedy shall be the right to give the Company notice at once of such breach, and thereupon if the Company does not take immediate steps to comply with the obligation so breached, the Government may terminate this contract.

Article 30.

Except as otherwise provided in Article 29 hereof, the penalty for the breach by the Company of any of its obligations under this contract shall be damages which shall be payable to the Government under the following conditions:—

The Government shall at once notify the Company of any alleged breach on the part of the Company, setting forth the nature of such breach. Any controversy which may arise as to whether or not the Company has committed the alleged breach shall be settled by arbitration in the manner provided in this agreement. Once that the fact of the commission of the breach has been established, the failure of the Company to take immediate steps to remedy the breach shall subject the Company to the payment of damages to the Government, and if such damages cannot be agreed upon they shall be determined by arbitration in the manner provided in this contract. The amount of any damages which may be so determined shall be paid to the Government by the Company within sixty days after such determination.

Article 31.

If any doubt, difference, or dispute shall arise between the Government and the Company concerning the interpretation or execution of this contract, or anything herein contained or in connection herewith, or the rights and liabilities of the parties hereunder, it shall, failing any agreement to settle it in another way, be referred to two arbitrators, one of whom shall be chosen by each party, and a referee who shall be chosen by the arbitrators before proceeding to arbitration. Each party shall nominate its arbitrator within thirty days of being re-

quested in writing by the other party to do so. In the event of the arbitrators failing to agree upon a referee, the Government and the Company shall, in agreement, appoint a referee, and in the event of their failing to agree they shall request the President of the Permanent Court of International Justice to appoint a referee. The decision of the arbitrators, or in the case of a difference of opinion between them, the decision of the referee, shall be final. The place of arbitration shall be such as may be agreed upon by the parties, and in default of agreement shall be The Hague, Holland.

ARTICLE 32.

The Company may not, without the consent of the Government, assign its rights and obligations under this contract to anyone, but it is understood that the Company, upon notifying the Government, shall have the right to assign its rights and obligations hereunder to a corporation it may organize exclusively for the purposes of this enterprise. The Company shall also have the right to create such other corporations and organizations as it may consider necessary or advisable for the purposes of this enterprise. Any such corporation or organization, upon being invested with any or all of the rights and obligations under this contract, and upon notification thereof to the Government, shall thereupon be subject to the terms and conditions of this agreement.

In the event that the shares of stock issued by any such corporation or organization should be offered for sale to the general public, the inhabitants of Saudi Arabia shall be allowed a reasonable time to subscribe (upon similar terms and conditions offered to others) for at least twenty per cent of such shares of stock so issued and offered for sale to the general public.

ARTICLE 33.

It is understood that the periods of time referred to in this agreement shall be reckoned on the basis of the solar calendar.

ARTICLE 34.

The effective date of this contract shall be the date of its publication in Saudi Arabia, following the ratification of this contract by the Company.

ARTICLE 35.

This contract has been drawn up in English and in Arabic. Inasmuch as most of the obligations hereunder are imposed upon the Com-

pany and inasmuch as the interpretation of the English text, especially as regards technical obligations and requirements relating to the oil industry, has been fairly well established through long practice and experience in contracts such as the present one, it is agreed that while both texts shall have equal validity, nevertheless in case of any divergence of interpretation as to the Company's obligations hereunder, the English text shall prevail.

ARTICLE 36.

To avoid any doubt on the point, it is distinctly understood that the Company or anyone connected with it shall have no right to interfere with the administrative, political or religious affairs within Saudi Arabia.

ARTICLE 37.

It is understood that this contract, after being signed in Saudi Arabia, shall be subject to ratification by the Company at its offices in San Francisco, California, before it shall become effective. After both texts of this contract have been signed in duplicate in Saudi Arabia, the signed copies shall be sent by registered mail in the next outgoing mail to the Company in San Francisco, California, and within fifteen days after receipt in San Francisco, the Company shall transmit to the Government by telegraph whether or not it ratifies this contract. If the contract is not ratified by the Company within fifteen days after receipt of the document in San Francisco, it shall be null and void and of no further force or effect.

Likewise, if the amount of the initial loan and the first annual rental is not paid within the time agreed upon in Article 18 hereof, the Government may declare this contract to be null and void and of no further force or effect.

Upon ratification of this contract by the Company, one signed copy of each text, together with the necessary evidence as to ratification by the Company, shall be returned to the Government. Also upon ratification of this contract by the Company, the contract shall be published in Saudi Arabia in the usual manner.

Signed this 29th day of May, 1933 (corresponding to the 4th day of Safar, 1352, A.H.).

[ABDULLA SULEIMAN AL HAMDAN]
On behalf of Saudi Arab Government.
(Signature)
(Seal)

L. N. HAMILTON
On behalf of Standard Oil Company of California.

PART II.—SUPPLEMENTAL AGREEMENT—1939

Between Saudi Arab Government and California Arabian Standard Oil Company.

Execution.

Signed at Riyadh, May 31, 1939.

Ratifications.

Ratified by California Arabian Standard Oil Company June 29, 1939, pursuant to a Resolution of the Board of Directors at a regular meeting held on the same date. Government notified July 1, 1939.

Ratified by His Majesty Abdul Aziz Bin Abdul Rahman Al Faisal Al Saud, King of Saudi Arabia, by Royal Decree No. 21/1/17 dated July 2, 1939.

Effective Date.

Became effective by publication in the Um-ul Qura, official Government journal, July 21, 1939.

Change in Company Name.

The name of the Company was changed from **California Arabian Standard Oil Company** to **Arabian American Oil Company** on January 31, 1944.

Extensions.

The term of the Agreement, and the term of Article 7, were extended for a period of two years by exchange of letters from the Minister of Finance to F. A. Davies dated January 18, 1941 and from F. A. Davies to the Minister of Finance dated January 19, 1941.

The above terms were extended for an additional period of two years by an exchange of letters from the Company to the Minister of Finance dated April 24, 1943 and from the Minister of Finance to the Company dated June 15, 1943.

This Agreement is made between His Excellency, Shaikh Abdulla Sulaiman Al Hamdan, Minister of Finance of Saudi Arabia, acting on behalf of the Saudi Arab Government (hereinafter referred to as the "Government") of the one part, and William J. Lenahan, acting on behalf of California Arabian Standard Oil Company (hereinafter referred to as the "Company") of the other part.

It Is Hereby Agreed between the Government and the Company in manner following:—

Article 1.

This Agreement, known as the Supplemental Agreement, is supplemental firstly to the Agreement (hereinafter referred to as the "Saudi Arab Concession") made between the Government of the one part and the Standard Oil Company of California of the other part and signed on the 29th day of May, 1933 (corresponding to the 4th day of Safar, 1352, A.H.) and secondly to the Letter of Agreement (hereinafter referred to as the "Second Principal Agreement") addressed by L. N. Hamilton, on behalf of the Standard Oil Company of California, to and accepted by His Excellency, Shaikh Abdulla Sulaiman Al Hamdan, on behalf of the Government, and bearing the same date as the Saudi Arab Concession.

Article 2.

The Saudi Arab Concession and the Second Principal Agreement have been duly transferred to and vested in the "Company" (party hereto) after notification to and with the consent of the Government, all in accordance with Article 32 of the Saudi Arab Concession, and the Company has duly undertaken and fulfilled to date the duties and obligations of the "Company" thereunder.

Article 3.

On the 16th day of October, 1938 (corresponding to the 22nd day of Shaaban, 1357, A.H.) the Company declared, under Article 10 of the Saudi Arab Concession, that oil had been discovered in commercial quantities, and all the obligations of the Company attendant upon such declaration have been duly fulfilled to date.

Article 4.

Both the Government and the Company are now desirous of adding to and otherwise extending the territory granted to the Company by

the Saudi Arab Concession, and of making such other modifications and alterations to the Saudi Arab Concession and to the Second Principal Agreement as hereinafter appear, and the Company has undertaken to make and the Government have consented to receive, the following payments to or for the benefit of the Government in manner hereinafter provided, namely:—

(a) The sum of one hundred and forty thousand English Pounds, Gold, or its equivalent, which sum shall become due upon the effective date of this Agreement.

(b) The sum of twenty thousand English Pounds, Gold, or its equivalent, annually as rental. The first of such payments, being rental for the year next following the effective date of this Agreement, shall become due upon the first anniversary of the effective date of this Agreement, and subsequent payments shall become due upon each succeeding anniversary of the effective date of this Agreement until the happening of any one of the following events, namely:—

1) Discovery of oil in commercial quantities within the additional territories described and referred to in Part Two and in Part Three of the Schedule to this Agreement, and which additional territories are hereinafter called the "additional area". If the Company shall fail to declare so sooner, the date of discovery of oil in commercial quantities shall be the date of the completion and testing of a well or wells within the additional area capable of producing, in accordance with first-class oilfield practice, at least 2,000 tons of oil per day for a period of 30 consecutive days.

2) The relinquishment by the Company of the whole of the additional area.

If either of the events mentioned in (1) and (2) above shall occur during the period intervening between any two anniversaries of the effective date of this Agreement, the rental payable for the year in which such event occurs shall be only that proportion of the annual rental above mentioned as the number of days that have intervened between the preceding anniversary date and the date of the occurrence of the event mentioned above bears to a full year of 365 days.

(c) The sum of one hundred thousand English Pounds, Gold or its equivalent, upon discovery of oil in commercial quantities within the additional areas aforesaid.

Each of the foregoing payments shall be made within 30 days from the date upon which it becomes due and shall be made in accordance with and in the manner provided in Articles 17 and 18 of the Saudi Arab Concession.

The foregoing payments are to be made by the Company in addition to any other payments by way of royalty or advance or otherwise already provided for by the Saudi Arab Concession and yet unpaid, and without prejudice to the right of the Company to recover advances already made under Articles 4, 6, and 11 and yet to be made under Article 11 of the Saudi Arab Concession, and to recover overpaid rental under Article 12 of the Saudi Arab Concession.

Article 5.

From the effective date of this Agreement, the terms and provisions of the Saudi Arab Concession, as herein amended, shall include and extend to:—

(a) All lands, islands, waters, territories and interests included in Article 2 of the Saudi Arab Concession, the description of which is repeated from the Saudi Arab Concession in Part One of the Schedule to this Agreement, and

(b) All lands, territories and interests described and referred to in Part Two of the Schedule to this Agreement, and

(c) All right, title and interest of the Government, now or hereafter, in or to the two territories described in Part Three of the Schedule to this Agreement and known respectively as the "Saudi Arab-Kuwait Neutral Zone" and the "Saudi Arab-Iraq Neutral Zone", and all rights and interests of a maritime or of a territorial nature now or hereafter appertaining to such two Zones or either one of them. And the Saudi Arab Concession shall be and is hereby modified to include all the lands, islands, waters, territories and interests of the Government described and referred to in the foregoing provisions of this Article, and henceforth the Saudi Arab Concession as modified by the Second Principal Agreement and by this Agreement shall be read accordingly. And, for convenience, all such lands, islands, waters, territories and interests may be referred to as the "exclusive area".

Article 6.

The following special provisions shall be applicable and shall have force and effect as from the effective date of this Agreement in regard to the Saudi Arab-Kuwait Neutral Zone and the Saudi Arab-Iraq Neutral Zone:—

(a) Computation of royalty accruing to the Government on oil and natural gas obtained from the Saudi Arab-Kuwait Neutral Zone and from the Saudi Arab-Iraq Neutral Zone shall be governed by the royalty provisions of the Saudi Arab Concession; it being understood, however, that the royalty as provided therein shall be payable to the Government only on that proportion of the total oil and natural gas so obtained as is represented by the Government's interest in the said Neutral Zones, respectively.

(b) The Company shall be entitled to enter into such Agreement or Agreements as it deems necessary or desirable to enable the Company alone or with another or others or through the medium of another Company or other Companies formed by it (either alone or in conjunction with others), to prospect for and develop and remove the petroleum and other hydrocarbon substances of and from the Saudi Arab-Kuwait Neutral Zone and the Saudi Arab-Iraq Neutral Zone or either one of such Zones; provided, however, that there shall be no violation of the provisions of Article 32 of the Saudi Arab Concession. So far as the Company or any Company or Companies formed by it is concerned, any such Agreement may contain the right of transport for all purposes of the enterprise by all manner of means of carriage over and along all ways within the Saudi Arab-Kuwait Neutral Zone and the Saudi Arab-Iraq Neutral Zone or either one of them and to and from any point or points within the said Zones from and to any point or points within Saudi Arabia. And the right in respect of the Saudi Arab-Kuwait Neutral Zone to use any ports and waterways free of all fees, dues, assessments and charges of any nature or kind whatsoever, in accordance with Article 21 of the Saudi Arab Concession.

(c) The Company may promote a Company or Companies of a nationality acceptable to the Government to explore and prospect for and exploit, remove and export petroleum and other hydrocarbon substances in and from both or in and from each or in and from either of the said two Neutral Zones.

Article 7.

The provisions of Article 9 of the Saudi Arab Concession shall henceforth be replaced by the following provision, namely:—

For a period of ten years from the effective date of this Agreement, the Company shall be under no obligation to relinquish to the Government any portion of the exclusive area covered by the Saudi Arab

Concession, as modified by this Agreement. Upon the expiration of this ten year period, and from time to time thereafter, the Company shall relinquish to the Government such portions of the exclusive area as the Company may decide not to explore further, or to use otherwise in connection with the enterprise. The portions so relinquished shall thereupon be released from the terms and conditions of the Saudi Arab Concession, as modified by this Agreement; provided, however, that the Company shall, notwithstanding such relinquishment, continue to enjoy the right reserved by the Saudi Arab Concession to use the portions so relinquished for transportation and communication facilities, the Company interfering as little as practicable with any other use to which the Government may desire the relinquished portions to be put.

Article 8.

That portion of Article 19 of the Saudi Arab Concession reading as follows: "during each year following the date of completion of this plant, the Company shall offer free to the Government, in bulk, two hundred thousand American gallons of gasoline and one hundred thousand American gallons of kerosene, it being understood that the facilities provided by the Government for accepting these deliveries shall not impede or endanger the Company's operations" shall be and the same is hereby amended to read as follows:

During the year following the first anniversary of the effective date of this Agreement, and during each year thereafter, up to and including the year ending on the anniversary of the effective date of this Agreement next following the discovery of oil in commercial quantities within the territories described and referred to in Part Two and in Part Three of the Schedule to this Agreement, the Company shall offer free to the Government, in bulk, one million three hundred thousand American gallons of gasoline and one hundred thousand American gallons of kerosene.

During the year commencing on the anniversary of the effective date of this Agreement next following such discovery of oil in commercial quantities, and during each subsequent year of the Saudi Arab Concession as amended by this Agreement, the Company shall offer free to the Government, in bulk, two million three hundred thousand American gallons of gasoline and one hundred thousand American gallons of kerosene.

It is understood that, following the completion of said plant, the gasoline and kerosene offered to the Government in bulk as aforesaid

shall be delivered to the Government at or in the immediate vicinity of the said plant. The facilities provided by the Government for accepting deliveries shall not impede or endanger the Company operations.

Article 9.

From the effective date of this Agreement, all the rights and privileges conferred by Article 22 of the Saudi Arab Concession may be exercised by the Company (a) anywhere in the "exclusive area" described in Article 5 of this Agreement; (b) anywhere in the area covered by the Concession granted on the 9th day of July, 1936 to the Petroleum Concessions, Limited (it being understood that the exercise of these rights by the Company in the area covered by the Concession granted to the Petroleum Concessions, Limited does not include the right to exploit oil therein nor will it damage the property of the Petroleum Concessions, Limited, or impede its operations and interests, or interfere therewith. The Government shall be the sole judge to determine this); (c) anywhere in the Saudi Arab-Kuwait Neutral Zone and in the Saudi Arab-Iraq Neutral Zone, to the full extent that the Government is entitled to grant such rights and privileges with respect to said two Neutral Zones.

The rights and privileges conferred by Article 22 of the Saudi Arab Concession may not be exercised by the Company in any other portion of Saudi Arabia, however, except with the express consent and approval of the Government; but it is understood, of course, that should the Company, in order to exercise the rights and privileges conferred by Article 22 of the Saudi Arab Concession, require rights of way from the territories described and referred to in Part Two of the Schedule to this Agreement to the area covered by the Concession granted to the Petroleum Concessions, Limited on the 9th day of July, 1936, the Government will not withhold approval of such rights of way.

Article 10.

The Saudi Arab Concession, as amended by this Agreement, shall, with respect to the territories described and referred to in Part Two and Part Three of the Schedule to this Agreement, continue in full force and effect for a period of six years from the expiration of the sixty year period provided in Article 1 of the Saudi Arab Concession.

Article 11.

The provisions of Article 3 of the Saudi Arab Concession and of Paragraphs 1, 2, and 4 of the Second Principal Agreement, in so far only as said provisions relate to the Saudi Arab-Kuwait Neutral Zone, are superseded by the provisions of this Agreement.

Article 12.

It Is Hereby Declared that the preference right granted to the Company by Article 3 of the Saudi Arab Concession and by the Second Principal Agreement, except as regards the "exclusive area" defined in Article 5 of this Agreement, shall remain in full force and effect during the term of sixty years from the effective date of this Agreement.

Article 13.

As modified by the foregoing provisions of this Agreement, the Saudi Arab Concession and the Second Principal Agreement shall continue in full force and effect (excepting to the extent to which certain provisions of the Saudi Arab Concession and the Second Principal Agreement shall have already been complied with and are therefore of no further validity) to the intent that, as from the effective date of this Agreement, all three documents shall be read together as and shall form one Agreement.

Article 14.

This Agreement has been drawn up in English and in Arabic and the provisions of Article 35 of the Saudi Arab Concession shall apply to this Agreement.

Article 15.

The effective date of this Agreement shall be the date of its publication in Saudi Arabia, following the ratification of this Agreement by the Company and by the Government.

Article 16.

It is understood that this Agreement, after being signed in Saudi Arabia, shall be subject to ratification by the Company at its offices in San Francisco, California, and by the Government in Saudi Arabia before it shall become effective. After both texts of this Agreement have been signed in triplicate in Saudi Arabia, two signed copies of

each text shall be sent by registered mail to the Company in San Francisco, California, and within fifteen days after receipt in San Francisco, the Company shall notify the Government in writing whether or not it ratifies this Agreement. If the Agreement is not ratified by the Company within fifteen days after receipt of the document in San Francisco, it shall be null and void and of no further force or effect.

Upon ratification of this Agreement by the Company, one signed copy of each text, together with the necessary evidence as to ratification by the Company, shall be returned to the Government. Also, upon ratification of this Agreement by the Company, the Government shall issue a Royal Decree announcing their ratification hereof, and officially publish that Decree and this Agreement.

Signed this 31st day of May, 1939 (corresponding to the 12th day of Rabi Thani, 1358, A.H.)

THE SCHEDULE ABOVE REFERRED TO.

PART ONE

All of eastern Saudi Arabia, from its eastern boundary (including islands and territorial waters) westward to the westerly edge of the Dahana, and from the northern boundary to the southern boundary of Saudi Arabia, provided that from the northern end of the westerly edge of the Dahana the westerly boundary of the area in question shall continue in a straight line north thirty degrees west to the northern boundary of Saudi Arabia, and from the southern end of the westerly edge of the Dahana such boundary shall continue in a straight line south thirty degrees east to the southern boundary of Saudi Arabia.

PART TWO

The following two areas in Saudi Arabia:—

(1) All that portion of Northern Saudi Arabia south of Iraq and south and east of Transjordania which is bounded on the east, south, and west by the following lines: (a) on the *east,* by a line commencing at the northern end of the westerly edge of the Dahana and running in a straight line north thirty degrees west to the northern boundary of Saudi Arabia; (b) on the *south,* by a line commencing at the northern end of the westerly edge of the Dahana and running in a westerly direction along the northern edge of the Great Nefud (leaving the great Nefud outside) to the northwest corner thereof, and thence in a straight line, passing through Tebuk, to the eastern boundary of

the area covered by the Concession granted on the 9th day of July, 1936 to the Petroleum Concessions, Limited; and (c) on the *west,* by a line commencing at the point where the straight line mentioned above joins the eastern boundary of the area covered by the Concession granted to the Petroleum Concessions, Limited and thence running in a northerly direction, along the eastern boundary of the area covered by the Concession granted to the Petroleum Concessions, Limited, until it reaches the present northern limits of the territory under the administration of Saudi Arabia, which adjoins the southern end of Transjordania.

(2) All that southern portion of Saudi Arabia which is bounded on the east, north, west and south by the following lines: (a) on the *east,* by a line commencing at the southern end of the westerly edge of the Dahana and running in a straight line south thirty degrees east to the southern boundary of Saudi Arabia; (b) on the *north,* by a line commencing at the southern end of the westerly edge of the Dahana and running in a westerly direction, fifty kilometers south of the most southernly branch of the Wadi Dawasir, to a point fifty kilometers south of the source of the Wadi Dawasir and thence continuing in a straight line to the northeast corner of the boundary line between Yemen and Saudi Arabia; (c) on the *west,* by a line commencing at the point where the straight line mentioned above joins the northeast corner of the boundary line between Yemen and Saudi Arabia and thence running in a southernly direction, along the eastern boundary of the Kingdom of Yemen, until it reaches the southern boundary of Saudi Arabia; and (d) on the *south,* by a line running along the southern boundary of Saudi Arabia between the most southernly limits of the lines mentioned under (a) and (c) above.

PART THREE

All the territory known as the Saudi Arab-Kuwait Neutral Zone, including islands and territorial waters if any which are or may become a part thereof, and all the territory known as the Saudi Arab-Iraq Neutral Zone.

ABDULLA SULAIMAN

On behalf of the Saudi Arab Government.

WILLIAM J. LENAHAN

On behalf of the California Arabian Standard Oil Company

PART III.—1950 AGREEMENT

Agreement concluded the 30th day of December, 1950, between the Government of Saudi Arabia, hereinafter called "Government," represented by His Excellency Shaikh Abdulla Suleiman Al Hamdan, Minister of Finance, and Arabian American Oil Company, hereinafter called "Aramco," represented by F. A. Davies, its Executive Vice President and Senior Resident Officer in the Kingdom of Saudi Arabia.

WHEREAS, the Government for a period of many months has been seeking additional revenue from Aramco, has had different views from Aramco on many long-standing interpretations of Aramco's Concession and other agreements, and has made many claims and exceptions which Aramco has contested as contrary to Armco's Concession rights and immunities; and

WHEREAS, the Government demanded amendment of certain conditions of Aramco's Concession and other outstanding agreements by letter dated 20 August 1950, and on 5 September 1950, submitted some thirteen points for discussion; and

WHEREAS, the Government on 4 November 1950 (23 Muharram 1370) and on 27 December 1950 (17 Rabi'a Al Awal 1370) promulgated income tax decrees providing, among other things, for the taxation of business profits within the Kingdom of Saudi Arabia; and

WHEREAS, both the Government and Aramco recognize the necessity for resolving all matters in dispute to the end that Aramco may proceed with the development of oil resources in the areas of Aramco's Concession in full agreement with and having full cooperation from the Government;

NOW, THEREFORE, it is hereby agreed as follows:

1. Anything in Article 21 in Aramco's Concession Agreement notwithstanding, Aramco submits to the income taxes provided in Royal Decrees No. 17/2/28/3321 and No. 17/2/28/7634 hereto attached for reference, it being understood

(a) that in no case shall the total of such taxes and all other taxes, royalties, rentals, and exactions of the Government for any year exceed fifty per cent (50%) of the gross income of Aramco, after such gross income has been reduced by Aramco's cost of operation, including losses and depreciation, and by income taxes, if any, payable to any foreign country, but not reduced by any taxes, royalties, rentals, or other exactions of the Government for such year; and

(b) that in all other respects, Aramco's exemptions and immunities set forth in Article 21 of the Concession Agreement shall continue in full force and effect.

2. It is further understood that:

(a) Aramco shall have the option to pay the taxes imposed by said decrees No. 17/2/28/3321 and No. 17/2/28/7634 in the currencies of Saudi Arabia or in other currencies in the proportion in which Aramco receives such currencies from its sales; and

(b) The term "exaction of the Government" as herein used shall include among other things, the amount of all fees and charges for services rendered to Aramco in excess of the cost of such services and all duties on imports by Aramco for Aramco, for its service organizations, and for the use and benefit of employees of Aramco and of such organizations except duties on food and items imported by Aramco for sale in its canteens.

3. The Government recognizes the continuing nature of the provisions of Articles 1 and 2 of this agreement and agrees that the new arrangement described therein constitutes a complete satisfaction of all outstanding claims and demands of the Government with respect both to the past and to the future; the Government agrees that Aramco may continue to conduct its operations in accordance with the Aramco Concession agreements in the same manner as in the past.

4. The following are examples of the effect of Article 3:

(a) The demands of the Government's letter of 20 August 1950, and the Government's points for discussion of 5 September 1950, are fully satisfied;

(b) Aramco's practices of using the English ton of 2240 pounds in the computation of royalties, selecting the locations for royalty gauging, taking natural salt for use in Aramco's operations, and using crude oil, gas, and petroleum products free of royalty in Aramco's operations and facilities in Saudi Arabia, are in accordance with the terms of the Concession Agreement;

(c) The Government agrees that Aramco may gauge and deliver oil to Trans-Arabian Pipe Line Company at Qaisumah; and

(d) The Jeddah Radio Agreement dated 6 March 1949 (7 Jamadi I, 1368) is in full force and effect.

These examples in no way limit the all-inclusive generality of Article 3.

5. The Government agrees that:

(a) The agreement concluded in the month of March, 1948, to the contrary notwithstanding, all monetary and currency exchanges between Aramco and the Government, including gold equivalents payable by Aramco to the Government, shall be at official rates recognized by the International Monetary Fund or by any other internationally accepted authority in case the International Monetary Fund is discontinued or no longer quotes exchange rates; and

(b) The Government will make available to Aramco Saudi Arab currencies, including gold, silver, and base metal coins, at the same rates as they are made available to the public. Aramco shall have the right to purchase Saudi Arab currencies on the open market at going rates. If the Saudi Arab Riyal rate should rise above the cost of minting new riyals plus transportation and insurance charges, the Government undertakes to supply Aramco's riyal requirements at cost plus said charges.

6. The free gasoline and kerosene to be offered the Government pursuant to Article 8 of the Supplemental Agreement dated 31 May 1939 (12 Rabi' Thani 1358) is hereby increased commencing 1 January 1951, to two million six hundred and fifty thousand (2,650,000) American gallons of motor gasoline per annum and to two hundred thou-

sand (200,000) American gallons of kerosene per annum, all in bulk at Ras Tanura. Aramco agrees further to offer the Government commencing 1 January 1951, seven thousand five hundred (7,500) tons per annum of road asphalt at Ras Tanura, said asphalt to be supplied in drums provided that drums are available at reasonable cost. No royalty shall be payable on crude oil required for the manufacture of gasoline, kerosene, and asphalt offered free by Aramco and taken by the Government. The costs of producing said crude oil and of manufacturing said free gasoline, kerosene and asphalt shall be accounted for as an expense of operations and not as an exaction within the meaning of Article 2, section b, of this agreement. It is understood that all said free gasoline, kerosene, and asphalt is for the ordinary requirements of the Government and not for sale inside or outside of Saudi Arabia.

7. Aramco agrees, commencing 1 January 1951, to pay the Government seven hundred thousand dollars ($700,000.00) per annum towards the expenses, support, and maintenance of representatives of the Government concerned with the administration of Aramco operations. Said amount of seven hundred thousand dollars ($700,000.00) shall be paid in equal installments in January, April, July, and October of each year and shall be accounted for as an expense of operations and not as an exaction within the meaning of Article 2, section b, of this agreement. The Government accepts Aramco's undertaking to pay said amount of seven hundred thousand dollars ($700,000.00) per annum as full satisfaction of all claims and demands for expenses, support, and maintenance of representatives of the Government concerned with the administration of Aramco's operations, including all such representatives of the national, provincial, and municipal governments, police, guards, guides, soldiers and officials of the customs, immigration, and quarantine services, it being understood that said payment without limiting the generality of the foregoing shall be in lieu of all claims for salaries, wages, expenses, transport, free services, residence, and construction of every description, and all payments and services otherwise accruing after 1 January 1951 pursuant to Article 20 of Aramco's Concession Agreement.

8. Aramco confirms its policy of conducting its operations in accordance with first-class oil field practice and its accounting in accordance with generally recognized standards. The Government, on its part, confirms the Government's confidence in the Management of Aramco in conducting Aramco's operations.

9. This agreement shall become effective on the date hereof and shall remain in full force and effect for the duration of the Concession Agreement.

IN WITNESS WHEREOF, the parties have signed this Agreement at Jeddah, Saudi Arabia, the 30th day of December 1950 (20 Radi'a Al Awal 1370).

Appendix 3. Saudi Arabian Tax Laws

PART I.—NOVEMBER 1950 DECREE

ROYAL DECREE No. 17/2/28/3321/21 MUHARRAM 1370

SUPPLEMENT No. 1335 TWENTY-SEVENTH YEAR

UMM AL-QURA

SATURDAY 23 MUHARRAM 1370 (4 NOVEMBER 1950)

With the Help of God Almighty

We 'Abdul 'Aziz Ibn 'Abdul Rahman Al Faisal

King of Saudi Arabia

In consideration of what has been submitted to us by our Minister of Finance regarding the necessity of increasing the income of the Government to enable it to carry the burden of general reforms, and to promote the general welfare of the country, and to improve the standards of living, we have agreed to the institution of an income tax in accordance with the Ordinance, the text of which follows, and which we have approved and for execution of which we have issued our order :

(Articles 1 to 9 are omitted since they deal only with taxes on individuals.)

Article 10.

Income of Companies

The word "company" in this Ordinance shall mean any company that is registered or that is required to be registered, in accordance with the Law for the Registration of Companies (approved by Royal Decree No. 144). This expression shall include also, all companies engaged in any kinds of business in the Kingdom of Saudi Arabia and where the Kingdom of Saudi Arabia has joint rights in the two Neutral Zones between it and either Iraq or Kuwait.

Article 11.

Rate of Tax

The rate of tax on companies shall be twenty per cent (20%) of their net profit, (as that profit is defined in this Ordinance). The tax shall be collected annualy.

Article 12.

Net Profit

The net profit of companies subject to the tax shall be the total gross income, as defined herein, after the deduction of the amounts which this Ordinance prescribes.

Article 13.

Gross Income

The gross income subject to the tax in accordance with this Ordinance shall be considered to be all the income, profits, and earnings of whatever kind and in whatever form paid, resulting from all kinds of industry and commerce such as buying and selling and financial or commercial transactions, and resulting also from dealing with and developing oil or other mineral resources, and from properties movable or immovable, including all income resulting from commissions, or from profits on shares or securities, or any profits or earnings resulting from any commercial transactions the object of which is profit, and earnings from any source whatsoever. There shall be considered as gross income for any company incorporated under the laws of any country other than Saudi Arabia, and carrying on its operations at the same time both outside and inside the Kingdom of Saudi Arabia, all the income which that company receives locally from any source whatsoever within the Kingdom. There shall be added thereto that part of the income which the company receives from the carrying on of operations both inside and outside the country as is derived from local sources. The Kingdom of Saudi Arabia, whenever and wherever it occurs in this Ordinance, shall include its joint rights in the two Neutral Zones between it and either Iraq or Kuwait.

Article 14.

Amounts Deductible under the Ordinance

Amounts which are deductible for the determination of the net profits of companies in accordance with this Ordinance are as follows:

a. All the ordinary and necessary expenses which the business or the enterprise requires and the expenditure of which takes place during the year, including therein a reasonable amount for the salaries of employees and for any compensation granted for any personal services.

b. Travel expenses which are connected with the business or the enterprise.

c. Rentals for properties rented in connection with the business or the enterprise.

d. Any losses incurred by the business or the enterprise and not compensated for in any way.

e. A reasonable amount for depreciation of properties which are used or employed in the operations.

Article 15.

Declarations

Every company subject to this Ordinance must file a declaration on the official form and pay the amount shown thereon to the official delegated by the Ministry of Finance for this purpose. The said declaration must be filed and the required amount paid on or before the fifteenth day of the third month following the end of the year for which the declaration was made.

In case of failure to file the declaration and to pay the amount within five days from the fixed time, there shall be added to the sum due a fine amounting to ten per cent (10%) of the tax. If the delay exceeds a period of fifteen days, the fine shall become twenty-five per cent (25%).

Article 16.

Rules for Calculation of Income

The taxpayer must enter in the records of his accounts all the gross income which he receives in the year received, and shall do likewise with the amounts deducted (except for depreciation and depletion). When the taxpayer proves the correctness of his records and that they reflect truly his gross income and the deductions, he may submit the declaration on the basis of those records. If an auditor who is legally and internationally recognized certifies to the correctness of those records for any year in which the tax is due, the declarations on the basis of the said records shall be considered as correct.

If the taxpayer declares that he keeps records in a clear manner on the basis of a financial year different from the calendar year, he may request the Ministry of Finance that it permit him to make his declarations in accordance with the financial year which he follows. In such case he shall submit declarations and pay the tax on the fifteenth day of the third month after the end of the financial year which he follows. Penalties for delay in submitting the declarations and in payment of the tax shall be as mentioned in Article 15 of this Ordinance.

Article 17.

Exempted from the Tax

There shall be exempt from the provisions of this Ordinance:

a. The Royal Family.

b. Officers and men of the armed forces, police, and coast guard.

c. Persons officially appointed to religious posts in mosques.

d. Foreign ambassadors, ministers plenipotentiary and other diplomatic representatives, consuls, and foreign consular representatives, on condition of reciprocal treatment and within the limits of this treatment.

e. Persons whose income does not exceed annually twenty thousand Saudi Arabian riyals.

f. Animals and plants on which the religious tax (*zakāt*) is paid.

g. Contributions and aids paid to the Government, charitable organizations, and institutions for social welfare which are recognized by the Saudi Arabian Government.

Article 18.

a. The Minister of Finance shall enforce the income tax laws and there shall be formed in the Ministry of Finance a special department for taxes.

b. To facilitate the enforcement of this Ordinance the Kingdom shall be divided administratively into not more than six districts, in accordance with what the Minister of Finance deems necessary for the administration and enforcement of this Ordinance. There shall be appointed for each district a director, who shall have therein an office where the inhabitants of the district shall submit their declarations and pay the taxes due from them according thereto. The aforesaid director shall receive the taxes due and shall pay them monthly to the Ministry of Finance.

c. There shall be in each district a committee composed of three qualified and expert persons to check the declarations and to decide whether it is necessary to add any amount to them. The Committee shall have the right to request the taxpayer that he present himself before it personally, or that he delegate someone to appear before it on his behalf. It shall have the right also to request the taxpayer or his agent to submit his records and books for checking, it being provided that those records and books shall be returned to their owner upon his request after the Committee has checked them.

d. When the Committee discovers a tax due and not mentioned in the declaration, or any tax on which declaration was not made, it shall have the right to collect the tax due and a fine amounting to twenty-five per cent (25%) from the properties of the taxpayer, in accordance with instructions which the district director will issue.

e. When the director of the district pays to the Ministry of Finance the taxes collected during any month of the year, he shall send an accompanying list covering names and

addresses of the persons who paid the taxes as well as the amount paid by each of them.

f. As for the companies incorporated outside Saudi Arabia and under the laws of the country in which they are incorporated, but carrying on operations both inside and outside of the Kingdom of Saudi Arabia, they shall submit their declarations to the tax department in Jeddah. The head of that department shall appoint a special committee composed of three qualified and expert persons to review and check their declarations. Those companies shall have the right to delegate any of their employees to appear on their behalf before the said committee, if such is requested. Such companies shall have the right to defend the correctness of the taxes about which investigation is in progress. The Committee shall have the right to check the records and accounts of those companies at any time it deems fit, but it shall not have the right to hold those records and accounts for such a period as to hamper the operations of the companies.

g. The Committee shall have no right to impose on the companies the additional taxes which it estimates except after obtaining the approval of the Minister of Finance or of whoever may be acting on his behalf.

Article 19.

The Minister of Finance is accorded full authority to take all measures necessary for the enforcement of this Ordinance and the collection of the taxes prescribed thereunder. This includes without limitation the employment and training of the necessary employees, the issuing of necessary official forms, instructions, and orders notification to taxpayers concerning payment of the taxes and whatever may be connected therewith, and obliging individuals and companies to keep records which will facilitate the collection of these taxes.

Article 20.

The tax prescribed by this Ordinance shall be effective for the first time beginning with the first of Muharram 1370 (13 October 1950).

PART II.—DECEMBER 1950 DECREE

ROYAL DECREE No. 17/2/28/7634/16 RABIA AL AWAL 1370

SPECIAL SUPPLEMENT

UMM AL-QURA

17 RABIA AL AWAL 1370 (27 DECEMBER 1950)

With the Help of God Almighty
We 'Abdul 'Aziz Ibn 'Abdul Rahman Al Faisal
King of Saudi Arabia.

In consideration of what has been submitted to us by our Minister of Finance and having reviewed the Royal Decree No. 17/2/28/3321 of 21 Muharram 1370, we have agreed to the institution of an additional income tax on companies engaged in the production of petroleum or other hydrocarbons in accordance with the ordinance of which the text follows and for the execution of which we have issued our order:

Article 1.

On every company registered or required to be registered in accordance with the Decree for the Registration of Companies (approved by Royal Decree No. 144) and engaged in the production of petroleum or other hydrocarbons in the Kingdom of Saudi Arabia, there shall be imposed for each taxable year ending after the date of this Decree, an income tax of fifty per cent (50%) of the net operating income. From such tax there shall be subtracted the amount provided in Article 3 of this Decree. The tax before the subtraction is referred to in this Decree as the "provisional income tax" and the tax after the subtraction as the "additional income tax".

Article 2.

Net operating income under Article 1 of this Decree means gross income described in Article 13 of Royal Decree No. 17/2/28/3321, after subtracting the following:

a. The amounts which are allowable as deductions under Article 14 of said Royal Decree, exclusive of amounts paid or payable to the Saudi Arab Government, and

b. Income taxes, if any, to the extent that such taxes have actually been paid by the company or are payable by it to any foreign country after the company has provided for the income taxes imposed by the Saudi Arab Government.

Article 3.

The amount to be subtracted under Article 1 of this Decree shall be the total of all taxes (except the income tax imposed by this Decree), royalties, rentals, duties, and all other sums paid or payable to the Saudi Arab Government. If the total of the foregoing exceeds the provisional income tax, then the excess shall be subtracted from the income tax which would otherwise be payable for the same taxable year under Royal Decree No. 17/2/28/3321.

Article 4.

The taxable year shall be the annual accounting period regularly followed in keeping the records of the company. Net operating income, gross income, deductions, and all other items relating to the taxable year and entering into the determination of income taxes shall be computed on the accrual method of accounting, if such method is regularly followed in keeping the records of the company.

Article 5.

Articles 15, 16, 17, 18, and 19 of Royal Decree No. 17/2/28/3321 shall be applicable to the additional income tax, unless differently provided for in this Decree. Such additional income tax and the income tax imposed by Royal Decree No. 17/2/28/3321 shall be paid in equal instalments once every three months commencing with the date the declaration on the official form is due. The Minister of Finance can grant reasonable extensions for filing the declarations and paying the income taxes imposed both by this Decree and by Royal Decree No. 17/2/28/3321.

PART III.—1956 REVISION OF NOVEMBER 1950 DECREE

By Royal Decree No. 17/2/28/576 dated October 19, 1956, the first 11 articles of Decree No. 17/2/28/3321 dated November 2, 1950, were amended, and paragraphs A, B, C, and E of Article 17 were canceled. The revised form of articles 10 and 11 is given below in a translation provided by the United States Department of Commerce since the other amendments deal only with the tax on individuals.

INCOME TAX LAW

Chapter II

The Tax on the Profits of Companies

ARTICLE 10.—PROFITS SUBJECT TO THE TAX ON COMPANIES

The phrase "profits of companies," insofar as these regulations are concerned, means the following:

1. The net profits realized by each company having non-Saudi capital that performs its operations within the Kingdom only or both within the Kingdom and outside of it at the same time.
2. The total dividends of non-Saudi partners from the net profits of companies having Saudi capital.
3. The total dividends of non-Saudi inactive partners [silent partners] from the net profits of limited liability companies.

ARTICLE 11.—THE RATE OF TAX IMPOSED ON THE PROFITS OF COMPANIES

The rate of tax on the net profits of companies will be as follows:

1. 20 percent on that part of the profits that does not exceed 100,000 riyals a year.
2. 30 percent on that part of the profits that exceeds 100,000 riyals and does not exceed 500,000 riyals a year.
3. 35 percent on that part of the profits that exceeds 500,000 riyals and does not exceed 1 million riyals a year.
4. 40 percent of that part of the profits that exceeds 1 million riyals a year.

The profits realized by any company will not be subject to the tax if tax has previously been collected on these profits in accordance with this ordinance.

Appendix 4. Selected Correspondence Between the Minister of Finance of Saudi Arabia and Aramco, 1950

Kingdom of Saudi Arabia,
Ministry of Finance,
Office of Mines & Companies,
Zul Qaida 6, 1369.
August 20, 1950.

No. 3633/474/1

The Respected Representative,
Arabian American Oil Company,
Jeddah, Saudi Arabia.

Greetings: As over 17 years have passed since the Oil Concession Agreement was concluded between His Majesty my lord the King's Government and the Standard Oil Company of California, and as circumstances and conditions at the time when the agreement was concluded distinctly differ from the present circumstances and conditions, and as the Company has succeeded in discovering areas rich with petroleum, more extensive and rich areas than what the Company expected, and the exploitation of which cost less than what it calculated,

And as His Majesty's Government has recently—after about 14 years have been spent by Aramco in actual reaping of the fruits of its concession—granted to another company, American like itself, a concession for development of oil in a small area, that compares nothing to the extensive areas covered by the concession of your Company, in the Kuwait neutral zone with conditions that greatly surpass the advantages and benefits of the concession granted to your Company,

And as the adjacent oriental governments have granted concessions for the development of petroleum in their countries which resemble to your Concession of Agreements in some conditions and differ in others,

And as His Majesty's Government feels that a long time has passed since Safar 4, 1354, corresponding to May 1933, when your Concession Agreement was concluded, during which time world conditions and circumstances have changed. With all these in view and following the principle that makes a nation entitled to get the greatest share of the profits of its natural wealth, and to keep up with developments that have actually taken place in such concessions in s milar countries, we feel that the time has come when we should discuss amendment of certain conditions in the agreements concluded between us and you. We therefore invite you to point out the earliest convenient time to commence discussions and delegate the au horized person or persons for this purpose.

Please accept our kind regards,

Abdullah Essuleiman,
Minister of Finance.

KINGDOM OF SAUDI ARABIA,
MINISTRY OF FINANCE,
Zul Qaida 22, 1369.
September 5, 1950.

No. 3919/515/1

The RESPECTED REPRESENTATIVE,
Arabian American Oil Company,
Jeddah, Saudi Arabia.

GREETINGS: In furtherance to our letter No. 3633/474/1 of Zul Qaida 6, 1369, corresponding to August 20, 1950, and with reference to the conversation we had with you on Zul Qaida 16, 1369, corresponding to August 30, 1950, during which you requested reply to the following three questions:

First: Does the Government desire to discuss reconsideration of amendment in all the Agreement articles, or only in certain articles thereof?

Second: Who are the party appointed by the Government to discuss this subject with the Company?

Third: Definition of the time at which the discussions should begin,

and also with reference to our meeting this morning, I wish to send you herewith a list of the points which the Government wishes to discuss with the Company and to confirm to you what I have already several times repeated that, His Majesty my lord the King has given His Royal Highness Emir Faisal and myself the authority to discuss with the Company and the power to decide in behalf of the Government on all subjects and points that we may reach an agreement with the Company, and therefore I requested you, and now request you once again, to appoint from your side persons responsible, fully empowered to discuss and decide with me on the points about which an agreement can be reached between us.

I hope the discussions will not be delayed longer than they have already been delayed, because there are matters of such importance that the Government can no longer wait for a determination about them and because the delay is of the greatest disadvantage from several points.

Please accept our regards,

ABDULLAH ESSULEIMAN,
Minister of Finance.

KINGDOM OF SAUDI ARABIA,
MINISTRY OF FINANCE,
OFFICE OF MINES AND COMPANIES.

First: (*a*) The Government wishes to define the term contained in Article (14) of the Agreement, namely (Ordinary operations in Company Establishments). The Government adheres to its interpretation of this term that it does not include oil used by the Company to produce steam in Ras Tanura Refinery or similar establishments.

(*b*) The Government wishes and insists on the increase of royalty from four gold shillings to six gold shillings.

Second: The Government requires from the Company to guarantee a yearly royalty for the Government not less than ten million English Gold Pounds or its equivalent in dollars or dollars and sterling, if an

agreement is reached between the Government and the Company on the rate of sterling.

Third: The Government requires from the Company to give the Government a portion amounting to 25 percent of Company's net profit on sales of crude oil or derivations and natural gas or derivations.

Fourth: The Government requires from the Company to give the Government a portion amounting to 20 percent of Company's net profit on sales of refined petroleum products from its refinery or refineries in the Kingdom of Saudi Arabia.

Fifth: The Government requires from the Company to increase the amounts of free gasoline and kerosene delivered to the Government from one million three hundred thousand gallons gasoline to three million gallons and from one hundred thousand gallons kerosene to three hundred thousand gallons.

Sixth: The Government requires from the Company annually and free of charge ten thousand tons packed in drums of asphalt suitable for making roads.

Seventh: The Government requires from the Company one hundred thousands dollars annually for salaries of Government representatives and delegates who represent the Government at the Company whether in Dammam or other oil fields within the Concession Area, and another amount of fifty thousand dollars annually for transportation, fuel and other miscellaneous costs.

Eighth: The Government requires amendment of Article (21) of the Concession Agreement.

Ninth: The Government requires from the Company to relinquish any land from the Concession Area in which at least five oil producing wells have not been drilled.

Tenth: The Government requires from the Company a statement showing the profits the Company made by the sale of shares of its Concession to Texas Oil Company, Socony-Vacuum Oil Co. and Standard Oil Company of New Jersey, and the Government claims from the Company, owning the Concession, 25 percent of the said profits.

In addition to these points the Government wishes to reach a solution on the following:

1. Royalty due on oil used in producing steam at Ras Tanura Refinery.

2. Company's contribution to the construction of Dammam Port and Dammam-Riyadh Railroad to such an extent as it would have actually costed the Company to construct the Dammam Port and Dammam-Abqaiq Railroad on its own account according to the proposition made previously by the Company to the Government.

3. The promise Mr. Moore made in behalf of the Company in his letter to His Majesty the King dated June 24, 1947, to pay two million five hundred thousand dollars annually for development projects commencing with 1948.

ABDULLAH.

Appendix 5. Treasury and Internal Revenue Service Correspondence Relative to Aramco Case

PART I. LETTER FROM ASSISTANT COMMISSIONER (TECHNICAL) TO DISTRICT DIRECTOR, UPPER MANHATTAN, N. Y.

January 11, 1955.

Re Arabian American Oil Co., Foreign Tax Credit.
T:R:C:ACG

District Director of Internal Revenue,
P. O. Box 145, Grand Central Annex,
New York 17, New York; Att: UM:A:AFO,
Assistant Commissioner (Technical).

This is in reply to your memorandum dated April 22, 1954, wherein you request that this office review a memorandum dated April 19, 1954, prepared by Internal Revenue Agent A. Frederick Olsen, Special Adviser, in which it is held that certain taxes imposed by the Saudi-Arabian Government in 1950 are income taxes within the purview of section 131 of the Code. Mr. Olsen's memorandum was prepared in response to a request by this office as to any conclusions which may have been reached by your office on this matter, in the examination of the returns of the Arabian American Oil Company, together with a statement or summary of the documents or other evidence upon which the conclusion is based.

The facts as disclosed by Mr. Olsen's memorandum are substantially as follows:

The taxpayer was incorporated on November 8, 1933, under the laws of the State of Delaware, as California Arabian Standard Oil Company to exploit the oil concession agreement which Standard Oil Company of California (SOCAL) received from the Saudi Arabian Government on May 29, 1933, and assigned to taxpayer in November 1933. "SOCAL" formed the taxpayer and owned all of its capital stock (3,500 shares of common stock of $100 par value) until 1936. On July 30, 1936, 3,500 shares of common stock were issued to The Texas Company of New York for $3,500,000 ($350,000 capital and $3,150,000 paid-in surplus); and the latter became half-owner until December 2, 1948, at which time 3,500 shares were issued to Standard Oil Company (New Jersey) and 1,166⅔ shares to Socony-Vacuum Oil Co., Inc., (New York). Taxpayer's name was changed to Arabian American Oil Company (ARAMCO) as of January 1, 1944. From the foregoing, it is noted that Standard Oil Company of California, The Texas Company, and Standard Oil Company of New Jersey each own 30 percent of the taxpayer's capital stock and Socony-Vacuum Oil Co., Inc., owns 10 percent.

In a letter dated October 27, 1953, addressed to Internal Revenue Agent David Rose, examining officer in this case, the taxpayer asserts that early in 1948 the Government of Saudi Arabia began to show dissatisfaction with the returns it was getting under the Concession and intimated that the imposition of an income tax was being con-

sidered. The taxpayer claims that during 1949 and 1950 it resisted such suggestion strenuously. The Saudi Arabian Government is said to have pressed the point that the United States Government was deriving very large revenues from taxation of the corporation's profits derived solely from the exploitation of Saudi Arabian natural resources.

The letter also states that the Government was aware of the 50/50 tax imposed by Venezuela and came to the conclusion that a similar tax should be imposed in Saudi Arabia. (See I. T. 4038, C. B. 1950–2, 54.)

In July 1950, the Government engaged an experienced tax attorney in the United States to come to Saudi Arabia to assist in the preparation of provisions to be incorporated in a Saudi Arabian income-tax decree. As a result of this visit, an income-tax degree was promulgated in November 1950, imposing a general income tax on persons and companies, which specifically included income derived from the exploitation of petroleum and other mineral resources. Also, a tax decree imposing additional income taxes upon petroleum companies was promulgated in December 1950.

The tax here involved was paid or accrued to the Government of Saudi Arabia pursuant to two Royal Decrees. The first of these is known as Royal Decree No. 17/2/28/3321, dated November 4, 1950; the second is known as Royal Decree No. 17/2/28/7634, dated December 27, 1950.

The decree of November 4, 1950, imposed a general income tax on incomes of individuals and corporations and applies to all persons except those specifically exempted. Article 11 thereof fixes the rate of tax on corporations at 20% "of their net profit, (as that profit is defined in this Ordinance)." The net profit is the total gross income less specified deductions. Under Article 20 the tax became effective for the first time beginning with October 13, 1950.

The decree of December 27, 1950, indicates in its preamble that it is "an additional income tax on companies engaged in the production of petroleum or other hydrocarbons * * *." Under Article 1 thereof it imposes an income tax of 50 percent of the net operating income less certain amounts provided in Article 3. Article 1 also provides that the tax is "imposed for each taxable year ending after the date of this Decree." Article 4 provides that the taxable year shall be the annual accounting period regularly followed in keeping the records of the company and that the accrual method may be employed in computing gross income, deductions, and all other items if such method is regularly followed in keeping the accounts.

In arriving at the additional tax payable under this second decree, the income tax payable under the November 4th decree is deducted from the tentative 50 percent computation.

The December decree as finally enacted is a modification of a draft submitted by Aramco to the Government. In an agreement dated December 30, 1950, Aramco agreed to submit to both the November and December decrees and waive its prior tax exemption. Article 3 of the agreement provides that it "constitutes a complete satisfaction of all outstanding claims and demands of the Government with respect both to the past and to the future."

There is no question that the tax imposed by the November decree is an income tax which must be allowed as a credit under section 131 (a)

of the Code, since such tax is generally imposed on all individuals and corporations. However, the December decree, although by its language is imposed on all of a class of taxpayers (companies engaged in the production of petroleum or other hydrocarbons), actually is imposed on only Aramco, since it is the only company engaged in that type of business in Saudi Arabi at the present time. The service has held that a credit will be allowed under section 131 (a) of the Code for an additional tax that is imposed solely on companies engaged in certain types of business (I. T. 4038, supra).

It is apparent that the taxpayer determined that it would be to its advantage taxwise to pay the taxes imposed by the November and December decrees and take such taxes on its Federal income-tax return as a credit under section 131 of the Code, rather than insisting that the Government honor the exemption from tax granted in the concession and probably paying an increased royalty to the Government, which would only be allowed as a deduction in computing its net income for Federal tax purposes.

Since our prior communication to you on this matter, a ruling has been issued to the Standard Oil Company of New Jersey, which holds that a proposed change in the Iranian Income Tax Laws which will enact a tax patterned after the Saudi Arabian decrees will be allowed as a credit under section 131, provided a royalty of approximately 12½ percent is also paid to the Government. A copy of that ruling is attached for your information. It should be noted that the proposed tax decree in this case was drafted by the taxpayer in the same manner as Aramco drafted a proposed tax decree which was subsequently enacted in December 1950.

On the basis of the above-stated facts, this office is in accord with Mr. Olsen's determination that Royal Decree No. 17/2/28/3321 and No. 17/2/28/7634 of the Saudi Arabian Government impose income taxes which are allowabe as a credit under section 131 (a) of the Internal Revenue Code subject to the limitations of section 131 (b) of the Code.

(Signed) LEO SPEER,
Acting Assistant Commissioner.

Enclosures: 2 copies of this memorandum Ruling to Standard Oil Co., dated 7/12, 1954.

ACGasperow: 8/6/54

See C. C. Memo—1/6/55.

	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer
Code	T. R. C.	T. R. C.	T R	T:R	CC:1:JCB		T
Surname	s/Gasperow	s/Edelschein	s/Miller, J. F., Jr.	s/Swartz	s/Bernhardt		s/Zucker
Date	8-9-54	8-9-54	8-10-54	8/11/54	11/20/54		1/7/55

PART II. MEMORANDUM FROM CHIEF COUNSEL'S OFFICE TO ASSISTANT COMMISSIONER (TECHNICAL) RELATIVE TO ARAMCO CASE

JANUARY 6, 1955.
G. C. M. 28595

CC:I:MAMcC:JCB
A–469660
In re: Middle East Oil Companies—Tax Offsets.
ASSISTANT COMMISSIONER (TECHNICAL):
(Attention: Director, Tax Rulings Division.)

Reference is made to your memorandum (T:R:C:ACG) dated August 13, 1954, referring to this office a proposed letter (T:R:C:ACG) addressed to the District Director of Internal Revenue, New York, holding that payments made in 1950 by the Arabian American Oil Company (referred to hereinafter as Aramco) to the Saudi-Arabian Government pursuant to Royal Decree No. 17/2/28/3321/21 of November 4, 1950 (referred to hereinafter as the November decree) and to Royal Decree No. 17/2/28/7634/16 of December 27, 1950 (referred to hereinafter as the December decree) are income taxes within the purview of section 131 (a) of the Internal Revenue Code of 1939, and that credit is allowable against United States income taxes for such payments, subject to the limitations of section 131 (b) of the 1939 Code.

According to statements submitted by Aramco and information obtained by Treasury Department representatives, the two decrees were promulgated under the following circumstances:

Aramco, which is a Delaware corporation owned by Standard Oil Company of California, The Texas Company, Standard Oil Company of New Jersey, and Socony-Vacuum Oil Company, Inc., has oil exploration and production rights in Saudi Arabia derived from concession agreements, first of which was granted in 1933 for a period of sixty years by the Saudi Arabian Government to Standard Oil Company of California. The basic royalty payable under the concession was "four shillings, gold, or its equivalent" per ton of crude oil plus certain amounts of gasoline and kerosene. Aramco was exempt from all direct and indirect taxes, with certain minor exceptions, but Saudi Arabia imposed no income tax prior to 1950.

Beginning in 1948 the Saudi Arabian Government pressed Aramco for modification of its concession agreement and indicated that it was considering enactment of an income tax law. The Government was disatisfied with the return which it was receiving from its oilfields, was aware that the United States was deriving large revenues through taxation of Aramco's profits from exploitation of Saudi Arabian natural resources and knew of the foreign tax credit provision of the 1939 Code. The Government was also aware of the 50 percent tax imposed by Venezuela on income derived from exploitation of its oil resources. (See I. T. 4038, C. B. 1950–2, 54.) Increasing pressure was exerted on Aramco for modification of its concession agreement and Saudi Arabia is said to have asserted that the tax exemption

which Aramco enjoyed under the concession would not include exemption from subsequently enacted income tax. Demands for changes culminated in a memorandum of 13 conditions proposed by the Saudi Arabian Government, including increase in the royalty rate to six shillings, gold, guarantee of a minimum yearly royalty, a share of the company's net profits from sales, amendment of Article 21 (exemption from taxes), increased payments of petroleum products, and certain cash payments in settlement of questions concerning the rate of exchange.

On November 4, 1950, Royal Decree No. 3321 was promulgated, imposing an income tax on persons and on corporations. Being aware that this tax imposed in spite of the claimed exemption, would not produce the amount which the Saudi Arabian Government had shown that it expected and being unwilling to pay an increase in royalties, further demand for which was anticipated, after protracted conferences which were not recorded, Aramco authorized its representatives to attempt a settlement and to agree to submit to the income tax and to additional income tax, provided that the sum of all taxes and other exactions of the Saudi Arabian Government and one-half of the United States income and profits taxes (after credit for foreign taxes) for the taxable year should not exceed 50 percent of the company's net income, computed without deduction for such other taxes, royalties, and exactions. A draft of a law imposing an additional income tax on oil companies patterned after the Venezuelan additional tax was submitted to the Saudi Arabian Government which revised the draft and promulgated the law as Royal Decree No. 7634. In an agreement dated December 30, 1950, Aramco then submitted to the income taxes imposed under the November and December decrees, with the understanding that in no case should the total amount of taxes, royalties, rentals, and exactions of the Government for any year exceed 50 percent of Aramco's gross income, less certain deductions; agreement was reached also regarding an increase in payments of petroleum products, certain cash payments, rates of exchange, and other points of difference. The Government accepted the arrangements made in the agreement as full satisfaction of its demands and claims.

In a letter dated November 23, 1954, received from the Arabian American Oil Company, it was stated that the so-called "gold pound controversy" between the Saudi Arab Government and the company, which was settled by the December agreement, was simply a question of the exchange rates to be applied in converting the company's gold obligations into dollars or pounds sterling at such time as the company was unable to obtain gold sovereigns with which to pay its concession obligations. At no time were Aramco's royalty obligations as set forth in the concession agreement increased or decreased. Its royalty obligation remained four shillings gold or its equivalent per ton on all net crude oil produced.

The November decree imposes a tax on the income of individuals and companies, both native and foreign, but exemptions derived from other laws are said to cause its impact to fall almost entirely on foreigners. Included in gross income subject to the tax is "all the income, profits and earnings * * * resulting also from dealing with and developing oil or other mineral resources. * * *" Article 11 fixes the rate of tax on corporations at 20 percent "of their net profit (as that profit is defined in this ordinance)" and Article 12 defines net profit,

as total gross income less certain deductions. Under Article 20 the tax became effective for the first time beginning with October 13, 1950.

The December decree imposes an additional tax on companies engaged in the production of petroleum or other hydrocarbons. A tax of 50 percent is imposed on the "net operating income" of the taxpayer subject to this decree; this tax is referred to as the "provisional income tax." ("Net operating income" is equivalent to gross income as defined under the November decree less deductions allowable under Article 14 of that decree, exclusive of amounts paid to the Saudi Arabian Government and less income taxes actually paid to a foreign country.) From the tax thus imposed all taxes (except the tax imposed by the December decree), royalties, rentals, duties, and other sums paid or payable to the Saudi Arabian Government are deducted; the resulting amount is known as the "additional income tax." If the total of the amounts to be deducted from the "provisional income tax" exceeds that figure, the excess is to be subtracted from the tax otherwise payable for the same taxable year under the November decree.

When the question of qualification of the November and December decrees as income-tax laws under section 131 of the 1939 Code was considered by the Service in response to an inquiry from the Department of State, this office approved a proposed letter to the Secretary (IR: IT: TR: APK–6) holding that the two decrees were income tax laws. No information other than the terms of the two decrees seemed to have been available at that time. On request of the General Counsel of the Treasury, dated December 7, 1951, the problem was reconsidered by the Service in the light of additional information obtained by the Treasury Department regarding the circumstances under which the decrees were promulgated. By memorandum to the General Counsel (IT: RP: CA JEN) dated March 27, 1953, the Commissioner affirmed the prior position of the Service. Attached to this memorandum was a Memorandum of Legal Authorities prepared in this office. Although additional information has now been obtained from Aramco relative to negotiations which preceded promulgation of the tax decrees and Aramco's waiver of exemption from income taxes, the facts thus disclosed do not appear to be substantially different from those known or assumed to exist when the case was previously considered.

Under the December agreement, Aramco not only submitted to the "taxes" imposed by the November and December decrees (Article 1) but also agreed to increased payments in kind to the Government (Article 6) and to make cash payments in lieu of payments which would otherwise accrue under the concession agreement after January 1, 1961 (Article 7). Saudi Arabia apparently made no additional concessions to Aramco but agreed that Aramco might continue to conduct its operations in accordance with prior concession agreements (Article 3). It is clear that the "additional income tax" was imposed in lieu of an increase in royalties for the future and that Aramco suggested such tax rather than a royalty increase in order to avail itself of the Federal tax benefits derived from paying an income tax as opposed to a royalty, but in the opinion of this office such facts do not per se preclude allowance of credit for the "additional income tax." Cf. A–610204, in re: Iran Income Tax Law—Amendment of, letter of July 12, 1954, addressed to Standard Oil Company of New Jersey; A–613339, in re: Standard Oil Company of New Jersey, letter of September 7, 1954.

As the Saudi Arabian Government imposed the "additional income tax" by a royal decree of continuing application which takes the form of a law taxing income determined according to United States concepts, applicable to all taxpayers within a certain class, this office is of the opinion that the "additional income tax" should be held to be an income tax within the purview of section 131 (a) of the 1939 Code provided that after the December 30, 1950, agreement Aramco continued to pay a reasonable royalty to Saudi Arabia. Cf. A–610204, supra; A–613339, supra, (holding that a proposed change in the Iranian Income Tax Laws enacting a tax patterned after the Saudi Arabian decrees would result in an income tax which could be credited against United States income tax, provided a reasonable royalty was paid. It was held that a royalty of approximately 12½ percent would be considered reasonable).

It is the understanding of this office that the royalty paid and to be continued in the case of Aramco at current rates of exchange is approximately 11 percent. From information submitted by attorneys for Standard Oil Company of New Jersey in connection with a conference held in the Treasury Department on April 12, 1954, it appears that the 11 percent rate paid in Saudi Arabia compares favorably with the rate in other nearby geographical areas such as 10 percent in India; 12½ percent in Basra, Mosul, and Turkey. Inherent in the position taken in your proposed letter to the District Director is the conclusion that a royalty of 11 percent is reasonable. This office concurs in that conclusion.

Inasmuch as the royalties paid by Aramco to Saudi Arabia appear to be reasonable in amount and as the royalties were not reduced at the time Aramco submitted to the income taxes provided in Royal Decree No. 17/2/28/3321 and Royal Decree No. 17/2/28/7634, it could not be said that such taxes were disguised royalties in whole or in part.

Accordingly, on the basis of the evidence submitted by you and on the basis of the facts as they have been represented by the taxpayer, this office is in accord with Mr. Olsen's determination that Royal Decrees No. 17/2/283321 and No. 17/2/28/7634 of the Kingdom of Saudi Arabia impose income taxes which are allowable as a credit under section 131 (a) of the Internal Revenue Code of 1939, subject to the limitations of section 131 (b) thereof. Opinion is reserved as to the effect upon the future allowability of the credit in the event there is any subsequent or additional adjustment of royalties at some future date.

In view of the past interest of the Treasury and the State Department, you may wish to refer this matter to the Treasury for its information or consideration.

R. P. Hertzog,
Acting Chief Counsel Internal Revenue Service.

Enclosures: Adm. file; CC Aramco's letter of 11–23–50.

(Noted NTS 1/6/55)

PART III. MEMORANDUM OF NOVEMBER 12, 1952, PREPARED IN THE OFFICE OF THE TAX LEGISLATIVE COUNSEL OF TREASURY

Subject: Saudi Arabian income tax and foreign tax credit under section 131 of the code.

PROBLEM

The problem discussed is whether a tax decree dated December 27, 1950, by the Saudi Arabian Government, affecting only a single domestic corporation, Arabian-American Oil Co. (hereinafter called Aramco), falls within the United States concept of an income tax for purposes of the foreign tax credit provided by section 131 of the code.

GENERAL FACTS

Saudi Arabia imposed two taxes in 1950: (1) In November, a general 20-percent tax on foreign corporations (after a $5,480 exemption) on gross income less ordinary and necessary business expenses, including depreciation (but not depletion); and (2) the December 27 decree on companies producing petroleum and other hydrocarbon products, a tax arrived at by applying a 50-percent rate on net income (with no allowance for depletion), without deduction for royalties, customs duties, taxes, and other exactions paid to the Saudi Arabian Government, and then reducing this figure by such payments made to the Government. Although the December decree is by its language applicable generally, it actually is imposed only on Aramco at the present time.

The effect of the two decrees on the payment of United States taxes by Aramco is startling. This may be presented graphically by the following table, comparing the returns of Aramco for 1949 and 1950.

	Gross sales	Net income before taxes	United States taxes	Saudi Arabia taxes	Net income after taxes
1949	$266, 230, 919. 92	$113, 849, 816. 05	$43, 262, 742. 12	0	$70, 587, 076. 93
1950	288, 495, 161. 22	110, 102, 028. 41	199, 032. 44	[1] $49, 443, 544. 62	60, 459, 451. 35

[1] Consisting of $32,871,401.02 tax under the November decree and $16,572,143.60 tax under the December decree.

These figures disclose that assuming the validity of Aramco's claim for foreign tax credit, United States revenue from Aramco alone have dropped approximately $43 million in the period of 1 year.

The following comments are concerned chiefly with the December tax decree. There appears to be little doubt that the November decree is a valid tax entitled to credit under section 131, since it applies generally to all foreign corporations and non-Saudi Arabian individuals.

In evaluating the December decree, account has been taken of the Bureau memorandum sustaining the tax for foreign tax credit purposes. It is believed, however, that the conclusion therein reached

fails to give adequate consideration to the factual background of the tax, and to the possibility that a foreign tax decree in form may be considered to be a royalty arrangement for United States tax purposes.

I. BACKGROUND OF THE DECEMBER DECREE

Aramco's oil concession stems from a concessions agreement in 1933 which contained a provision whereby Aramco's predecessor was given an exemption for 60 years "from all direct and indirect taxes, imposts, charges, fees and duties (including of course import and export duties) * * *." Its monetary obligation was basically to make royalty payments. This situation continued through the year 1949, during which Aramco paid no taxes to the Saudi Arabian Government.

In 1950 the Saudi Arabian Government expressed dissatisfaction with the 1933 concessions agreement and demanded amendment of certain of its conditions, chiefly for the purpose of securing additional revenue from Aramco. Thus on September 5, 1950, the Saudi Arabian Government presented 13 demands. Items marked "first (B)" and "eighth" are significant. The former states: "The Government wishes and insists on the increase of royalty from 4 gold shillings to 6 gold shillings [per ton of crude oil]." The latter states: "The Government requires amendment of article (21) of the concessions agreement [relating to Aramco's tax exemption]." The problems were resolved in the agreement concluded December 30, 1950. This agreement referred to a Government letter of August 20, 1950, demanding amendment of the concessions agreement, the Government's 13 points of September 5, 1950, and the November and December tax decrees. It then provided that the company agrees to submit to the taxes provided by the November and December decrees, with the express understanding that the total taxes, royalties, rentals, and exactions of the Government for any year shall not exceed 50 percent of the gross income of Aramco, after allowance of certain costs and deductions. The Government affirmed Aramco's concession under the 1933 agreement except as modified.

From the foregoing, it is believed that it may be possible to draw the following conclusions:

(1) The Government bound itself by the 1933 concessions agreement to collect a stipulated royalty from oil operations in Saudi Arabia by Aramco's predecessor and to exempt it from any taxes;

(2) The Government was dissatisfied with its royalty income from Aramco and sought to increase its yield;

(3) The Government had no interest revenuewise whether the increased revenue was from increased royalties or taxes, although it mattered significantly to Aramco because of the operation of the United States foreign credit on foreign taxes;

(4) To the extent that the United States bore the burden of the increased payment to the Government, Aramco too would have no objection to scrap the tax exemption provided it by the 1933 concessions agreement;

(5) The November and December 1950 tax decrees and the December 30, 1950, agreement were all part and parcel of a new agreement providing increased revenue to the Government from its oil properties;

(6) To the extent that Aramco submitted to the November tax

decree providing a general tax on income of foreign corporations, it would seem difficult to deny Aramco foreign tax credit for taxes paid pursuant to such decree; and

(7) In view of the foregoing and of the fact that the December decree is levied only against Aramco, the Government may be able to sustain in court the argument that the December decree partakes so much of the nature of an agreement for royalties that taxes paid thereunder may be denied foreign tax credit under section 131 of the code.

II. THE LEGAL ARGUMENT FOR DENYING FOREIGN TAX CREDIT FOR TAXES PAID UNDER THE DECEMBER DECREE

A. *Section 131 and its purpose*

Section 131 allows a foreign tax credit for the "amount of any income, war profits, and excess profits taxes paid or accrued during the taxable years to any foreign country," including "a tax paid in lieu of a tax upon income, war profits, or excess profits otherwise generally imposed by any foreign country * * *." The meaning of the words "income taxes" is determined by our own criteria, *Biddle* v. *U. S.* (302 U. S. 573).

The memorandum submitted by the Bureau contained a lengthy background on the legislative purpose of section 131. For the purpose of this memorandum, it is believed desirable to emphasize that the purpose of the foreign tax credit provision was to avoid the payment of double taxes (to both the United States and the foreign government) on the same income. The tax credit is not intended to apply to amounts paid in lieu of royalties paid to a foreign government since obviously such amounts do not involve double taxation of income.

B. *Factors which disqualify the December 1950 tax decree as an income tax entitled to credit under section 131*

It is believed that based upon the following factors, the December decree does not fulfill United States concepts of an income tax for purposes of the section 131 credit.

(1) *The December decree affected only Aramco, one concern, and was not general legislation.*—One indication of a royalty agreement as distinguished from a tax is that it relates to only one concern. The December decree although applicable to "companies engaged in the production of petroleum or other hydrocarbons" actually applies to only one company, Aramco, at the present time. It is not without significance, it is believed, that it was only the month before, that a general 20-percent income tax was levied against foreign corporations. Although conceivably the provisions of the December decree could have been incorporated in the November decree, this was not done, possibly because the Government had not reached complete agreement with Aramco as to a revision of the 1933 concessions agreement.

The Tax Court in the case of *New York and Honduras Rosario Mining Company* v. *Comm.* (8 TC 1232, rev'd., 168 Fed. (2d) 745 (CCA 2d, 1948)), placed some emphasis on this factor in reaching its conclusion that the tax in that case was not entitled to credit under section 131. Because this case is believed significant in any evaluation of the December tax, a discussion of it seems desirable. Taxpayer, a domestic corporation, had been engaged in gold and silver mining

operations in Honduras. All mining operations were subject to a comprehensive mining code, one of the provisions of which imposed a minimum 5-percent tax upon the "liquid profits" of the corporation, the exact rate to be fixed by contract with the executive power, with special approval of the National Congress. A contract was entered into, approved by the National Congress, for taxpayer's exploitation of its Rosario mines at a 7-percent rate for a 20-year period, and of its other mining properties at a 5-percent rate for 10 years. the rate to be subject to change after 10 years. Another provision guaranteed to taxpayer during the life of the contract that it would not be subject to taxes, imposts, duties, services, or contributions of any kind other than those which exist at the time in the Republic.

On these facts and on the fact that a $250,000 advance was required, repayable from the 7-percent payments, but not if operations were suspended, the Tax Court denied foreign tax credit, holding in effect that the Honduran Government exacted the payments in question for the right and privilege of taxpayer to operate and exploit its mines in Honduras. It pointed out that the tax affected only the taxpayer and could not be considered general legislation.

In reversing, the circuit court held the payments to be in the nature of an income tax. It placed some significance on the fact that Honduras in its mining code levied excise taxes in addition to the tax in question, the former taxes only, carrying a penalty of forfeiture of the mines. The circuit court conceded that the Honduran tax differs from our Federal income tax in permitting a tax rate to be determined by contract approved by the National Congress. It held, however, that the basic 5-percent tax was not changed by the additional 2 percent reached by negotiation.

In the present case, the December tax was applicable only to Aramco, and became effective only upon consummation of the December 30, 1950, agreement and as a part thereof. It was not a part of the general income tax provided by the November decree. Under such circumstances, it is expressly distinguishable from the circuit court decision in the Honduras case and falls within the rationale of the Tax Court decision which denied foreign tax credit for the reason among others that the tax was not general legislation.

(2) *The December decree was basically part of the agreement for raising the royalty rate provided by the 1933 concession agreement and in substance was not a tax.*—As indicated above, Aramco was exempt from tax under the 1933 concessions agreement. Neither the November nor the December tax decrees therefore appeared to apply to Aramco, since its tax exemption was effective for a period of 60 years. In the absence of any indication otherwise, the two tax decrees became applicable to Aramco only when the exemption was modified by the December 30, 1950, agreement. In that agreement Aramco agreed, notwithstanding the concessions agreement, to submit to the income taxes provided by the November and December decrees. This submission, however, was with the understanding that in no case shall the total of such taxes and all other taxes, royalties, rentals, and exactions of the Government exceed 50 percent of Aramco's net income excluding such payments to the Government. Moreover, as part of the same agreement, the Government agreed that "Aramco may continue to conduct its operations in accordance with the Aramco concession agreements in the same manner as in the past."

The above would seem to indicate that although the obligation of Aramco to pay tax seemed to stem from the December decree, it actually arose under the December 30, 1950, agreement, in which Aramco agreed to relinquish its tax exemption and the Government agreed to permit Aramco to continue its oil operations. Payments made under such an agreement are payments for the privilege of exploiting oil properties and are royalties in nature even though designated as taxes.

It may be argued that the same argument could be made with respect to payments made pursuant to the November decree. To an extent this may be true. However, the important distinguishing feature between the two decrees is that the November decree did impose a general income tax. Although under its 1933 concessions agreement, Aramco was also exempt from the November tax it seems difficult to say that submission to this tax converted a tax, generally applicable, to a royalty payment by Aramco.

At this point it may be well to recall the New York and Honduras case referred to above, for two reasons: (*a*) If the Tax Court decision be deemed correct (and the circuit court reversal should not necessarily be finally determinative to this issue), then the payments made pursuant to the December 1950 decree and the December 1950 agreement should be similarly treated as royalties rather than taxes. The Tax Court distinguished other cases cited by taxpayer. It stated: "In no case cited was the rate determined and fixed in a contract between the taxpayer and the Government wherein the Government in the same instrument grants the right for which the payments thereunder are paid as is here done." In this case, too, the Government could have imposed the November and December decrees without entering into the December 30, 1950, agreement. But this would have risked opposition by Aramco, and possible cessation of operations to the detriment of the Saudi Arabian Government interests (compare the Iranian oil situation). The agreement was therefore necessary for the interest of the Government so that it could secure increased compensation from its oil properties on terms satisfactory to Aramco. At the same time it affirmed Aramco's right to continue to exploit the Government properties. It was a quid pro quo entirely foreign to the concept of a tax decree.

(*b*) If the circuit court decision should be deemed valid law, then the statement in its decision that the Honduras tax differs from our concept of an income tax in permitting a tax rate to be determined by contract, deserves emphasis. For in this case the December tax was submitted to as part of the December 30, 1950, agreement; the latter was entered into after negotiations involving Government complaint against the provisions of the 1933 concessions agreement; and the December tax decree was not a part of the November decree.

(3) *Assuming that the December decree may be considered an income tax decree in form it should not be granted tax credit if actually a substitute for royalties.*—Consideration of this point is believed vital in any evaluation of the December decree. An oil company leasing lands from a private individual would generally pay royalties to him dependent upon the quantity of oil produced. It cannot get tax credit for such royalties, whether or not the lands and the lessor are situated abroad, and even if the amount of the royalty is based on net income. It is

not believed the situation changes because the lessor is a sovereign government which can secure its "royalties" by a tax decree.

In view of the facts that the 1933 royalty rate was unduly low, the Government had demanded a rate of 6 shillings per ton instead of 4 shillings only about 2 months prior to the December 1950 tax decree and agreement, and the revenue from exploitation of the properties was actually increased, it would seem, under the circumstances, that at least a part of the additional revenue was a substitute for royalties which would be payable if the lessor were a private individual. The additional taxes provided by the December decree, applicable only to Aramco should, at least presumptively, be the measure of the increased royalties, absent proof by Aramco that a lesser amount constituted the substitution. This point is believed valid even though a sovereign government may secure the additional revenue as tax despite its contractual obligation. The United States, however, should not accept such payments as taxes to the extent they appear to be royalties. Section 131 was not designed to grant credit for royalty payments however designated for they are like excise taxes which except under certain limited circumstances (see sec. 131 (h) of the code and Reg. 111, sec. 29.131–2) are not granted foreign tax credit. The reason, applicable to both cases, is that the burden of such payments may be shifted through the price mechanism to another, and thus there is no need to give relief from double taxes.

There is evidence in the December decree and the December 30, 1950, agreement, which further supports the view that the December taxpayments were substitutes for royalties. Thus, under the December decree, a dollar reduction in royalties results in a dollar increase in the December tax. Acceptance of the December decree involves not only acceptance of the present factual situation. It involves also the possibility that further increases in the United States tax could be immediately offset by further increases in the payments under the December decree. This could be done, not by raising the rate of the December tax, but by simple reduction of the royalty rate to the extent necessary to bring up the tax to an amount sufficient to offset the United States tax. Thus, downward revision of the royalty rate alone results in revision of the "tax" payable under the December decree. In this connection, it may be relevant to note that the royalty rate was in effect reduced by the December 30, 1950, agreement, in that payment of royalties under this agreement to be made at the official rate of exchange of $8.25 per gold sovereign (or approximately $1.65 for each ton of crude oil) instead of $12 ($2.40 per ton) as agreed to in March 1948.

There is further evidence of the interrelationship between the December tax decree and the payment for exploitation of the oil properties. The December decree provides that if the royalty and other payments to the Government should exceed 50 percent of Aramco's income (determined without deduction for such payments) resulting in no tax under the December decree, the excess should be subtracted from the November income tax. Thus, even the tax required to be paid pursuant to the general November income tax must yield to the principle that the Government is entitled to share equally in Aramco's income from the properties, but no more. These provisions point up the fact that the payments made under the Decem-

ber decree were compensation for exploitation of the Government's oil properties, i. e., royalties.

It is recognized that there are no direct cases in point which sustain the approach taken; neither are there direct cases to the contrary.

However, there is substantial Supreme Court authority indicating that literal compliance with statutory language may not suffice if the realities of the situation dictate otherwise. To the extent that the amounts paid by Aramco constitute royalties although appearing to be taxes, they should be treated as royalties. An indication that a court may do just that may be found in the case of *Amtorg Trading Corp.* v. *Comm.* (65 F. (2d) 583 (C. C. A. 2d, 1933)). The question in issue was the deductibility of approximately 50 percent of the profits paid by the taxpayer, a domestic corporation, to a Russian Government agency for the privilege of acting as buying and selling agent in Russia for American trade. A substantial portion of the stock was held by a Russian governmental agency. The circuit court allowed the deduction as ordinary and necessary business expenses. Its dictum per Learned Hand, judge, may be worth quoting since it is believed to bear closely on the instant problem.

"If the taxpayer had been wholly a governmental agency, convenient for local purposes of American trade, and if the Government had held the entire beneficial interest in it, the payments would no doubt be distributions. * * * Had that been true, it would have been most extraordinary to impose a license fee; hardly explicable except as an effort to escape taxation. * * *"

Further on, the court stated:

"It would indeed make a difference if the payments had themselves been fixed with an eye to taxes; or if for any reason they were not truly what they appeared. * * * But there is no reason here to suspect that the Russian Government fixed the fees higher than if it had had no interest in the corporation" (65 Fed. (2d) at p. 586).

Applying this reasoning by analogy, there may be sufficient evidence to indicate that the December decree was "fixed" with an eye to taxes and that the amount paid pursuant thereto really constituted royalties, not entitled to foreign tax credit.

Conclusion

It is concluded that the Aramco's payments pursuant to the December 1950 decree and agreement should be denied foreign tax credit.

In arriving at the conclusion, it is realized that the decision may or may not be sustained in court. It is recognized that there is considerble justification for the Bureau position that such payments should be allowed foreign tax credit. However, there is a paucity of authority on the problem; and the problem has never been squarely faced by a court whether payments made pursuant to a tax decree under circumstances indicating they are, in substance, royalties should be granted foreign tax credit. It is believed that there is sufficient doubt of the answer and that the revenue consequences, both for this case and the future, are serious enough that the United States should not submit to the taxpayer's position without court test. In any case, it is believed that the problem should be considered for submission to the Congress for appropriate legislative remedy.

Appendix 6. Memorandum Sent With Covering Letter (Dated April 16, 1954) From Mr. Douglas Erskine (Tax Division Manager) of Arabian American Oil Company to Mr. A. Frederick Olsen, Special Adviser, Internal Revenue Service, Office of District Director, Upper Manhattan, N. Y.

The Saudi Arab Government at various times between 1948 and 1950 had indicated its dissatisfaction with the terms of the existing Concession and asserted that changes in conditions since the Concession had been negotiated in 1933 justified changes in that agreement. Various Government officials had shown that they were aware of the possibilities of the foreign tax credit allowed by the United States. In December of 1948, they had questioned George Eddy, a United States Treasury official who was advising them in monetary stabilization matters, regarding the credit and had been told by Mr. Eddy that, as he understood it, their information that taxes paid to a foreign government could be credited against the United States tax was correct. Later in December, the Government's legal advisor stated that he knew that taxes paid to foreign governments could be deducted from tax paid the United States and, while he realized that the Company was exempt from the payment of taxes to the Saudi Arab Government, he felt that the Government was justified in imposing a tax if such tax were deductible from United States taxes. Thereafter, with progressively increasing insistence, the Government called upon Aramco to consider modification of the Concession so as to increase the Government's revenue and coupled its representations with pointed references to the possibility of an income tax. Being aware of the Venezuelan pattern, both because it had been published in the newspapers and because a Saudi Arab delegation had visited Venezuela to obtain information on the administration of Venezuelan oil properties, references to income taxes were based upon a 50/50 pattern.

The pressure had become so serious by July of 1949 that the subject was given thorough discussion within Aramco's Management. The Directors quickly discarded any idea of increasing the Company's fixed payments since that would impair the Company's competitive position, and consideration was given to submission to an income tax as an alternative to a refusal to make any concessions at all. Inquiries were made of Mr. George McGhee, then in charge of Middle East affairs for the State Department, as to whether or not the State Department would support Aramco's refusal to recede from its Concession and, if it did recede to the extent of submitting to an income tax, what the attitude of the State Department might be. Mr. McGhee then stated that the Department could not take a stand on complete refusal by the Company to modify the Concession. He also stated, after consultation with the Treasury, that he believed that the income tax question was primarily a subject to be discussed between the Company and the Treasury Department, but that the Treasury would probably not take a position until a Saudi Arab

income tax law was enacted. Being unwilling to increase fixed payments and lacking support for the tax approach, the Company, after further consideration, elected to adhere to its agreement and to refuse the Government's demands.

Pressure from the Government continued to increase and it added to its reasons for dissatisfaction the fact that the United States was receiving larger returns from the Saudi Arab oil than was the Saudi Arab Government. It was quite frank in its demands that the Company must do something to rectify this situation and pointed to a Saudi income tax as the obvious solution. At one point, an official of the Government stated that if the Company continued to be recalcitrant, it might become necessary to require the Company to become a Saudi Arab corporation. The Government's legal advisor also advanced and strenuously argued the proposition that the tax exemption was an invalid abrogation of sovereign power and that the Government had a right to impose an income tax in spite of the exemption.

The matter reached a climax during August and September of 1950. In July, the Company had been requested to recommend two American income tax lawyers from which the Government might choose one to assist it in preparing an income-tax decree. The Company did so, but neither of the lawyers which it recommended was selected by the Government. The Government did, however, employ Mr. John Greaney, an American lawyer in tax practice in Washington, D. C., as its tax advisor, and he arrived in Saudi Arabia about the middle of August. He was there approximately a month and prepared recommendations and a draft of an income-tax law which he left with the Government. Mr. Greaney did not consult with the Company and the content of the law which he drafted was unknown to the Company until that law was promulgated in November 1950.

Meanwhile, in August, the Government demanded discussion of amendments to the Concession Agreement and, in September, made a series of concrete demands against the Company. These are contained in the letters of August 20, 1950, and September 5, 1950, copies of which have been furnished to you.

Among the demands were three groups material here: first, a demand for an increase in the royalty with provision for a minimum amounting, at the U. S. price for gold, to more than \$82 million; second, a demand for a share in the profits; and, third, a demand for an amendment to Article 21 of the Concession.

These demands, together with the fact that the Government was known to have provided itself with a draft income tax law, were strong evidence that it was prepared to act. It was also apparent that such action might go beyond the mere imposition of an income tax and involve the Company in additional fixed payments to which it was definitely opposed.

At first, the Company considered the feasibility of refusing the demands and in relying on its Concession. Evidence that the Government's revenues from its oil compared favorably with those of other Middle East countries and that there was no occasion for any change in the Concession was prepared. In October, this approach was discussed with the Saudi Arab Ambassador to the United States and the Company was unequivocally told that such a response would court disaster, that the Government was in no mood to be put off any

longer and that the most serious consequences could be expected if the Company persisted in such course.

Shortly thereafter, Company representatives called again on Mr. McGhee and were told again that, while the State Department was interested in upholding the integrity of agreements between foreign governments and U. S. corporations, it had also to recognize that longstanding contracts were subject to modification from time to time and the Department could not take a strong stand in support of a refusal to make any change in the Concession. He did say, however, that, as he assumed that the Company was prepared to yield in one direction or another, he hoped that the arrangements would take some form other than a change in royalty rate. He suggested that the pattern established in Venezuela would be less disturbing in the Middle East than a change in the fixed royalty rate.

As indicated in my letter of October 27, 1953, it would have been useless, and, in view of the Ambassador's advice, dangerous, to resort to the courts of Saudi Arabia. Some submission was a necessity. After protracted consideration, it was concluded that the Company could not and would not accede to any increase in fixed payments by way of royalty or otherwise and that the course which the Company would adopt in dealing with these demands would be by submission to the demand for modification of Article 21.

While the Company was still struggling with its efforts to reach a decision, Royal Decree No. 3321 was promulgated. It was significant that it provided in its definition of gross income for the inclusion of income resulting from dealing with and developing oil or other mineral resources. It was clear that the law had been specifically designed to include the profits of Aramco and the conclusion that this decree was a step in a course of action on which the Government had embarked was confirmed. Although the Company at that time advised a Government representative orally that it considered itself exempt from the tax imposed by this decree, it nevertheless recognized in its own deliberations that the tax was aimed in part of it and that recession with respect to Article 21 would involve it in this income tax. It was also apparent that this tax alone would not produce the amount which the long series of discussions with the Government had shown it expected. It was known that the Government was much impressed by the arrangement in Venezuela under which the Venezuelan Government received a minimum of 50 percent of the profits, and any arrangement would have to meet this criterion. An increase in royalties being ruled out as a matter of policy and also as not consistent with the Government's longstanding wish to impose a tax, it was decided to meet the Government's demands only to the extent of modifying Article 21 and submitting to an income tax as high as 50 percent if necessary. The deliberations leading to this conclusion were protracted and were not recorded. They culminated in a specific authorization to Aramco's Management, a copy of which is attached.

Accordingly, when the Company's representative arrived in Jiddah in November 1950, this course was suggested. It was made clear at that time that the Company was not prepared to accede to an additional royalty and that the only course it was prepared to take was submission to an income tax along the Venezuelan pattern. The Government representatives having proved interested but having little idea of how an additional income tax might be framed, a draft

tax decree was prepared and submitted for its consideration. The draftsmen were instructed that no increase in royalty was to be provided and that all that was contemplated was an income tax. This draft was extensively reviewed within Government circles and, with some modifications proposed by the Government, became Royal Decree No. 7634, to which the Company submitted in the Agreement of December 30, 1950.

As enacted, Decree No. 7634 provided for the deduction of any U. S. tax which might have become payable. The effect of this was to reduce the Saudi Government's tax and correspondingly increase the U. S. tax in any case in which the U. S. tax exceeded the allowable credit. Hence, the Saudi tax was a substitute for the U. S. tax only to the extent that a U. S. tax credit was allowed. This provision was removed from the law in 1952.

April 16, 1954.